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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1920.

MERCHANTS' LOAN & TRUST COMPANY, TRUSTEE OF THE ESTATE OF ARTHUR RYERSON, DECEASED,
Plaintiff in Error,

vs.

JULIUS SMIETANKA, FORMERLY UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF ILLINOIS,
Defendant in Error.

WRIT OF ERROR TO THE DISTRICT COURT OF THE UNITED STATES, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.

BRIEF AND ARGUMENT ON BEHALF OF PLAINTIFF IN ERROR.

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Counsel for Plaintiff in Error.

WALTER L. FISHER,
Also of Counsel.

GUNTHORP-WARREN PRINTING COMPANY, CHICAGO.

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Defendant in Error.

WRIT OF ERROR TO THE DISTRICT COURT OF THE UNITED STATES, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.

STATEMENT OF THE CASE.

State of the record: This is an action in assumpsit on a special count to recover from the defendant sums assessed under an Act of Congress known as the Federal Income Tax Law, approved September 8, 1916, as amended March 3, 1917, and October 3, 1917, as an income tax upon the increase in value of certain shares of stock and bonds while the same were held by the plaintiff in error and its predecessors, as trustees under the will of Arthur Ryerson, deceased. A demurrer to the declaration was sustained. The plaintiff in error stood by its declaration and the suit was dismissed. The case is brought here by a writ of error on the ground that the validity of an Act of Congress under the Constitution of the United States is involved.

The jurisdiction of the Supreme Court: The declaration averred that the Acts of Congress under which the tax in question was levied and assessed on the alleged income were contrary to the Constitution of the United States in this: That the tax was not apportioned among the states according to population, as required by Art. I, Sec. 2, cl. 3 and Sec. 9, cl. 4 of the original Constitution of the United States and that the tax attempted to be assessed and levied under the Act of Congress was not a tax on income within the meaning of the Sixteenth Amendment to the United States Constitution. Under the rule of *Towne* v. *Eisner,* 245 U. S. 418, plaintiff in error was entitled to sue out a writ of error for a review of the judgment of the District Court in the United States Supreme Court.

Omitting the formal parts, the declaration made the following averment of facts: The plaintiff in error is the successor in trust to the original trustees under the will of Arthur Ryerson, deceased. Arthur Ryerson died on April 15, 1912, leaving a will devising the residue of his estate to trustees upon trust to pay the net income of the trust estate to his widow for life and at her death to transfer the trust estate to the testator's five children, provided that no child should receive his or her portion before reaching the age of 25 years and until that time should receive the net income for support and maintenance. Then there were gifts over if any child died leaving lawful issue before the date of distribution, to such issue and a gift over if any child should die without leaving issue before the time of distribution, then his or her share was to be held and managed by the trustees until the youngest surviving child reached the age of 25 years, when such share or shares were to be divided among the surviving children and their issue *per stirpes.* The trustees were given the usual powers of investing, convert-

ing and reconverting, with power to vary securities and change investments in their discretion. It was provided that while the trustees "shall be the final judges as to what net income is, and their determination in this respect shall bind all parties interested in my estate," the following exception was made:

> "except that it is my will that stock dividends and accretions of selling values shall be considered principal and not income."

The widow and five children survived the testator. The widow and four children are still living. One son died since the testator without issue.

At the time of the testator's death he was the owner of nine thousand five hundred and twenty-two (9,522) shares of the preferred capital stock of Joseph T. Ryerson & Sons, and these, together with other property, passed by the residuary clause of the testator's will to the trustees named in the will and, as the declaration specifically alleges, were held from the time of the testator's death to the 2nd day of February, 1917, continuously "as part of the principal of the estate of Arthur Ryerson, deceased, in the hands of the trustees of said estate." On February 2, 1917, these shares of stock were sold by the trustee. On March 1, 1913, the stock so sold had a cash value of $561,798; on January 1, 1914, $637,-074; on January 1, 1915, the same; on January 1, 1916, $714,150; on January 1, 1917, $1,263,567.50; on February 2, 1917 (the date of sale) it was sold for $1,280,996.64.

In October, 1917, the Federal Income Tax Law was amended, greatly increasing the federal income taxes and having a retroactive effect from the beginning of 1917. Under the Federal Income Tax Act of September 8, 1916, as amended March 3, 1917, and October 3, 1917, the government assessed an income tax upon a sum equal to the difference between the value of the above

mentioned shares of stock on March 1, 1913, and th amount for which they were sold on February 2, 191 claiming that said difference was income received in th year 1917. This income as so calculated by the goverr ment amounted to $719,198.14.

On January 8, 1914, the trustees of the estate of Ar thur Ryerson, deceased, acquired ten (10) first mortgag five per cent bonds of the Cudahy Packing Company and paid therefor the sum of $9,962.50, which was thei fair cash value at said date. These bonds were held as part of the principal of the trust estate continuously from the time of purchase until May 2, 1917, when they were surrendered to the maker thereof upon call duly made and the trustees under the will of Arthur Ryerson, deceased, received in payment therefor the total sum of $10,250, being an increase in the value of the capital invested in said bonds of $287.50. This sum the government also assessed as income acquired in the year 1917.

The profit of $719,198.14 derived from the sale of the stock and of $287.50 arising from the redemption of the bonds was taken by the government as making a total income of $719,485.64 derived in the year 1917 and a tax was assessed by the government against the trustee on the basis of such an income. This tax amounted to the sum of $311,242.51. This tax was paid under protest and the present suit was brought to recover the amount so paid.

The declaration alleges that the full proceeds of the sale of stock and the full proceeds arising from the redemption of the bonds were invested by the trustees in other securities and, pursuant to the directions specifically set forth in the will of the decedent, were thenceforward and now are held intact as part of the principal of the trust estate created by the will of Arthur

Ryerson, deceased; that no part of said proceeds was, or has been, distributed by the trustees as income to the life tenant under said will, or to any other person; that the stock was sold by the trustees for the sole purpose of transferring the assets of said estate represented by the investment in said stock from an investment in a manufacturing business of fluctuating value and income return to the form of a permanent trustees' investment; that neither said estate nor the plaintiff in error, as trustee thereof, nor their predecessors in trust, nor either of them, as such trustees, were or are now engaged in the business of buying and selling securities.

It should be noticed that the government did not assess the tax on the increase accruing each year since March 1, 1913, on the basis of the act in force in each year. If it had, the total tax would have been approximately $30,000. Nor did the Government take into consideration that the increase in the value of the capital assets if it ever came into the hands of any persons for their own separate use, benefit and disposal might be distributed to a number of remaindermen, represented at the time of the tax by the five children of the testator—a number, however, likely to be increased by the death of these children before the death of the life tenant leaving children. The Government did assess the tax upon the entire gain made during the whole period from March 1, 1913, till the time of sale in 1917, as a gain in and for the year 1917 and as a gain "derived," "received" and "drawn by" a single individual for his own use, benefit and disposal.

The errors assigned: Plaintiff in error has assigned the following errors:

1. The sustaining of the demurrer and dismissing the suit.

mentioned shares of stock on March 1, 1913, and the amount for which they were sold on February 2, 1917, claiming that said difference was income received in the year 1917. This income as so calculated by the government amounted to $719,198.14.

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Ryerson, deceased; that no part of said proceeds was, or has been, distributed by the trustees as income to the life tenant under said will, or to any other person; that the stock was sold by the trustees for the sole purpose of transferring the assets of said estate represented by the investment in said stock from an investment in a manufacturing business of fluctuating value and income return to the form of a permanent trustees' investment; that neither said estate nor the plaintiff in error, as trustee thereof, nor their predecessors in trust, nor either of them, as such trustees, were or are now engaged in the business of buying and selling securities.

It should be noticed that the government did not assess the tax on the increase accruing each year since March 1, 1913, on the basis of the act in force in each year. If it had, the total tax would have been approximately $30,000. Nor did the Government take into consideration that the increase in the value of the capital assets if it ever came into the hands of any persons for their own separate use, benefit and disposal might be distributed to a number of remaindermen, represented at the time of the tax by the five children of the testator—a number, however, likely to be increased by the death of these children before the death of the life tenant leaving children. The Government did assess the tax upon the entire gain made during the whole period from March 1, 1913, till the time of sale in 1917, as a gain in and for the year 1917 and as a gain "derived," "received" and "drawn by" a single individual for his own use, benefit and disposal.

The errors assigned: Plaintiff in error has assigned the following errors:

1. The sustaining of the demurrer and dismissing the suit.

2. The holding of the court below that the tax alleged in the amended declaration was not in violation of Art. I, sec. 2, cl. 3, or Art. I, sec. 9, cl. 4 of the original Constitution of the United States.

3. The holding of the court below that the tax alleged was a tax on income within the meaning of the Sixteenth Amendment of the Constitution.

4. The holding of the court below that the tax alleged in the amended declaration was a tax on income within the meaning of the Income Tax Law of September 8, 1916, as amended March 3, 1917, and October 4, 1917.

5. The holding of the court below that any part of the price received from the sale of stock or redemption of bonds constituted taxable income to the plaintiff in error and that the conversion into money of the shares of stock and redemption of bonds resulted in taxable income.

6. The holding of the court below that the conversion of the shares of stock resulted in a taxable income wholly within the year in which the conversion occurred and its refusal to hold that the conversion of the shares of stock into money resulted in taxable income (if at all) in each year since March 1, 1913, according to the increase in the value of the stock in each year since that date.

POINTS AND AUTHORITIES.

Part 1.

ASSUMING (FOR SAKE OF ARGUMENT ONLY) THAT THE INCOME TAX ACT OF 1916-17 ATTEMPTED TO [illegible] AS INCOME THE INCREASE IN VALUE SINCE MARCH 1, [illegible]13, OR DATE OF PURCHASE SUBSEQUENT TO THAT TIME, O[illegible]HE STOCK AND BONDS IN QUESTION UPON THE ASCERTAINMENT OF THE INCREMENT OF VALUE BY CONVERSION OR REDEMPTION, THE ACT WAS IN VIOLATION OF THE CONSTITUTION OF THE UNITED STATES.

I. The conception of income as authoritatively stated in *Eisner* v. *Macomber*, 252 U. S. 189, at 207, is as follows (the italics are the court's):

> This means "*not* a gain *accruing* to capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and coming in, being '*derived*,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description."

II. In accordance with the statement of this court last above quoted, it is now settled that the mere increase in the value of capital assets (prior to any conversion or redemption) is not "income" within the meaning of the Sixteenth Amendment:

Eisner v. *Macomber*, 252 U. S. 189.
Gray v. *Darlington*, 15 Wall. 63, 66.
Lynch v. *Turrish*, 247 U. S. 221, 231.

III. The conversion by the trustee in the case at bar does not cause the increase in the value of capital assets to be income. 26

A. The increase after the single isolated event of conversion remains capital just the same as it was before. The increase after conversion remained a mere "gain accruing to capital," or a "growth or increment of value in the investment." It was not "severed from capital." The change in form by the conversion does not make any change in substance. 26

B. As between life tenant and remainderman, the increase in value of capital assets of a trust estate consisting of stocks and bonds ascertained by conversion, continues to be capital of the trust estate and not income. 29

1. Cases holding that for the reason stated the life tenant was primarily not entitled to the increase in the value of stock ascertained by conversion, but the same was held as capital for the benefit of the remainderman: 30-33

Smith v. *Hooper*, 95 Md. 16, 26-31.

Stewart v. *Phelps*, 71 App. Div. (N. Y.), 91 (affirmed 173 N. Y. 621).

Guthrie's Trustee v. *Akers*, 157 Ky. 649.

Boardman v. *Mansfield*, 79 Conn. 634.

Connolly's Estate, 198 Pa. St. 137.

Re Kemble's Estate, 201 Pa. St. 523; 51 Atl. 310.

Matter of Kernochan, 104 N. Y. 618 (point "Second," p. 625).

2. Where there is a partial or complete liquidation of the assets of the corporation, payments made, even out of assets arising from accumu-

lated earnings, are distributions of capital, and, primarily at least, not distributable to the life tenant to whom only the income has been given: 33-35

In re Armitage [1893], 3 Ch. 337.

Bulkeley v. *Worthington Society*, 78 Conn. 526, 532.

Wilberding v. *Miller*, 88 Oh. St. 609 (for full report of opinion see 106 N. E. 665).

3. Even where a state court is committed to the apportionment of a stock dividend between life tenant and remaindermen according to the so-called Pennsylvania rule, the mere increase in the value of stock ascertained on conversion by a trustee for life tenant and remaindermen is capital and not income and therefore primarily not distribuable to the life tenant: 36

Re Kemble's Estate, 201 Pa. St. 523.

Connolly's Estate, 198 Pa. St. 137.

Re Graham's Estate, 198 Pa. St. 216.

Re McKeown's Estate, 106 Atl. 189 (Pa. 1919).

Thayer v. *Burr*, 201 N. Y. 155 (case of winding up corporation and distribution of assets).

Re Stevens, 98 N. Y. Supp. 28 (187 N. Y. 471) (case of corporation winding up).

Stewart v. *Phelps*, 71 App. Div. (affirmed 173 N. Y. 621).

4. Even if the *dicta* in some of the foregoing cases seem to support a rule that the mere increase in the value of stock, ascertained on conversion by a trustee for life tenant and re-

remaindermen, when *affirmatively* shown to be the result of earnings of the corporation since the life estate commenced and held by the corporation in such liquid form as to be available for dividends, is distributable to the life tenant, yet

a. Such a rule is to be supported (if at all) *not* on the ground that the gain is income, but *in spite of the fact that it is capital*—the increment of value being distributed to the life tenant because of an expressed intent of the creator of the trusts, based upon surrounding circumstances, or upon an assumed intent founded upon equitable considerations.

b. That this is the true ground for such a decision appears from the fact that in *Towne* v. *Eisner*, 245 U. S. 418, and *Eisner* v. *Macomber*, 252 U. S. 189, this court ignored as irrelevant, decisions apportioning stock dividends between life tenant and remaindermen.

5. Some cases have intimated that a special context which provides that the life tenant shall have not only the "income," but also something in addition thereto and described as "gains," or "profits," is effective to warrant the distribution to the life tenant of an increase in the value of stock ascertained by conversion:

U. S. Trust Co. v. *Heye*, 224 N. Y. 242, 253, 254.

Smith v. *Hooper*, 95 Md. 16.

6. So far as bonds are concerned, their increase in value never goes to the life tenant except by explicit direction: 38

Re Graham's Estate, 198 Pa. St. 216.
Matter of Gerry, 103 N. Y. 445.
Devenney v. *Devenney*, 74 Oh. St. 96 (77 N. E. 688).
Whittingham v. *Schofield's Trustee*, 67 S. W. 846 (Ky.).

7. In the case at bar the terms of the will expressly make the increase in the value of stocks and bonds capital, as between life tenant and remaindermen. 37-38

C. In view of the cases above cited and the "common understanding" which they indicate with regard to the meaning and scope of the word "income," the reasoning of the dissenting opinion in which Mr. Justice Holmes and Mr. Justice Day concurred in *Eisner* v. *Macomber* (252 U. S. 189), is favorable to the claim that the increase in value in question in the case at bar was not taxable income. 38

D. In the case at bar the tax can only be paid by the conversion and use of the capital of the trust estate—capital which belongs, as capital, to the life tenant during her life—capital of the life tenant which is taken to pay a gain of the remaindermen, who have not yet, and may never receive it. 40

Eisner v. *Macomber*, 252 U. S. 189, 213.

E. If the position of the parties were reversed, as they would be under an act which provided that there might be deducted "all losses in transactions in which a gain, if it occurred, would be in-

come within the Sixteenth Amendment," the Government would hardly permit the contention that a loss in the value of capital assets could be deducted from the income, so that all tax on the income would be wiped out and the income actually received, without deducting the loss, paid to the life tenant free of any tax, and the loss loaded onto the remaindermen.

IV. The gain or increase has not been "'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal."

A. The trustee does not derive any gain for his separate use, benefit or disposal. The life tenant cannot have the increase for her separate use and disposal. The remaindermen are not yet entitled to it and may never receive it because losses may occur to wipe it out.

B. A gain, which is before conversion a mere increase in the value of capital assets, to become income by conversion, must be derived, received or drawn by some one for his separate use, benefit and disposal.

Eisner v. *Macomber*, 252 U. S. 189, 207, 215.

C. This is entirely consistent with the holding that gains which are admittedly gains "proceeding from capital," such as rent, dividends, interest and profits from a business—all admittedly income—may be taxable as income though they are by special direction to be accumulated and added to capital.

D. The interposition of a trusteeship for life tenant and remaindermen causes to remain capital after conversion a gain which would not be capital

if the conversion were by a legal and beneficial owner.

49

1. In the stock dividend case (*Eisner* v. *Macomber, supra*) it was held that a *bona fide* corporate form and the *bona fide* declaration of a stock dividend prevented a gain accruing to the stockholder being income, for the reason that the interposition of the corporate form and the act of the corporation prevented the gain being derived or received by the stockholder for his separate use, benefit and disposal, and left it capital as it was before the stock dividend.

2. So, a *bona fide* trusteeship—as in the case at bar—if it in fact prevents an increase in the value of capital assets, which were before conversion mere accessions to capital and not income, from coming on conversion to the hand of any person for his separate use, benefit and disposal, also prevents the gain ascertained on conversion, from becoming income.

V. In the case of a trustee who sells a capital asset which he has received by devise, there is no realized profit or gain upon which to base any claim of income, because there is no cost or outgo at the beginning of the transaction to correspond with the conversion at the end.

51

VI. Even, however, where the legal and beneficial owner of capital assets sells them at a profit as a single isolated transaction (he not being in any sense in the business of buying and selling for profit) and ascertains the gain in cash and uses the same as he pleases, the gain is not income within the Sixteenth Amendment. 52

A. The mere increase in the value of capital assets is not income prior to the conversion: 52

Eisner v. *Macomber*, 252 U. S. 189.

B. A conversion, as a single isolated event, leaves the proceeds of the capital assets just as much capital assets as was the property prior to conversion. The change is one of form and not of substance. 52

C. The authoritative decisions and declarations of this Court, both before and since the Sixteenth Amendment, forbid the conclusion that the mere act of converting capital assets into cash, results in an increase in the value of capital assets, definitely ascertained thereby, becoming income. 57

1. *Gray* v. *Darlington*, 15 Wall. 63.
2. *Lynch* v. *Turrish*, 247 U. S. 221.
3. The Turrish case did not go upon the fact that the increase in the value of the capital assets occurred prior to March 1, 1913:

Lynch v. *Hornby*, 247 U. S. 339.
Peabody v. *Eisner*, 247 U. S. 347.
Eisner v. *Macomber*, 252 U. S. 189.
Gray v. *Darlington*, 15 Wall. 63.

D. Under the British Income Tax Act (16 and 17 Vict. c. 34) it is established that appreciations in value of capital assets, even after the realization of profits by sale, do not constitute taxable income, except in cases of transactions by dealers or other persons who buy and sell for purposes of profit. 68

1. See the following cases:

Tebrau (Johore) Rubber Syndicate, Limited v. *Farmer*, S. T. 5 Income Tax Cases, 658.

The Hudson's Bay Company v. *Stevens*, 5 Income Tax Cases, 424.

The Assets Company, Ltd. v. *The Inland Revenue*, Cases in the Court of Session, 4th Series, Vol. 24, p. 578.

2. The same distinction was recognized by this Court in *Gray* v. *Darlington*, 15 Wall. 63.

E. If the increase in the value of capital assets ascertained on conversion as a single isolated event, is not income prior to conversion, but becomes income only upon conversion, then it must either be income in the year when the conversion occurs and taxable as the income of that year, no matter how long the increase in value has been accruing, or it must be income in each year in which the increase occurs and taxable as income only in each year that it occurred under the act in force in that year. 71

1. If the court takes the first horn of the dilemma, then it permits a tax, not on the gain in each year, which, while it is not income, is nevertheless the basis of the alleged income, but upon the act of conversion by which all the gains for many years come to hand.

2. If the court takes the second horn of the dilemma, it must in one breath say that a mere increase in the value of capital assets is not income, but capital, and that on conversion the increase which was not income at all, becomes income for the year in which the increase occurred, when it was capital and not income.

F. There is nothing in the decisions or opinion of this Court denying full effect to *Gray* v. *Darlington* and *Lynch* v. *Turrish*. 73

1. The Doyle case (*Doyle* v. *Mitchell Bros. Co.* 247 U. S. 179, and the Hays case (*Hays* v. *Gauley Mountain Coal Co.* 247 U. S. 189) arose under the Corporation Excise Tax Act of 1909 and the validity of that Act. Its application did not involve any question of whether the tax was on income as distinguished from capital.

2. Both cases construed the Corporation Excise Tax Act by an examination of many of its provisions and the consideration of its express purpose, as taxing "the conduct of the business of corporations organized for profit" and measuring the tax by "the gainful returns from their business operations and property." Neither case involved a construction of the word "income" standing alone, as it does in the Sixteenth Amendment.

3. When this Court said, in *Eisner* v. *Macomber*, 252 U. S. 189, 207:

> " 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include *profit gained through a sale or conversion of capital assets*, TO WHICH IT WAS APPLIED IN THE DOYLE CASE,"

it only referred to the case where the profit was gained in the course of business operations, *as was the fact in the Doyle case.*

4. The statement of the court in *Eisner* v. *Macomber*, referring to the sale by a stockholder of the new shares acquired in a stock dividend (p. 212):

"It is equally true that if he does sell,

and in doing so realizes a profit, such profit, like any other, is income, and so far as it may have arisen since the Sixteenth Amendment is taxable by Congress without apportionment. The same would be true were he to sell some of his original shares at a profit,"

cannot be regarded as referring to the conversion of a capital asset as a single isolated event.

Part 2.

THE ACT OF 1916-17, BY ITS PROPER CONSTRUCTION, DOES NOT PERMIT THE ASSESSMENT OF ANY TAX UPON THE INCREASE IN VALUE OF THE CAPITAL ASSETS IN QUESTION.

I. Explicit language by Congress is required before the court will so construe the Act that it will operate to tax as income for the year of conversion the total increase in the value of capital assets occurring over an extended series of years. 77

Gray v. *Darlington*, 15 Wall. 63.
Lynch v. *Turrish*, 247 U. S. 221.
Towne v. *Eisner*, 245 U. S. 418.

I. *Gray* v. *Darlington* and *Lynch* v. *Turrish* are decisive that the Act of 1916-17 does not apply to any increase in the value of capital assets ascertained by conversion as a single isolated event. 79

A. *Gray* v. *Darlington* and *Lynch* v. *Turrish*, in construing the Acts of 1867 and 1913, respectively, are decisive that those Acts did not allow any tax upon an increase in the value of capital assets ascertained on conversion as a single isolated event. 79

B. The Act of 1916-17 is so far substantially like the Acts of 1867 and 1913 that the same ruling

must apply to it. The difference between "derived," or "for," or "arising or accruing" in the Acts of 1867 and 1913 and the word "received" in the Act of 1916-17 is insufficient to make any difference in result which would require a tax upon an increase in the value of capital assets as income. 83

Maryland Casualty Co. v. *United States,* 251 U. S. 342.

C. Section 2 (c) of the Act of 1916-17 is a mere appendage to Sec. 2 (a) and must, in its scope, follow the construction to be given to "sales or dealings in property" in Sec. 2 (a), and those words in Sec. 2 (a) must be confined to sales or dealings "in trade or commerce" and do not apply to the conversion of capital assets as a single isolated event. (See next heading III.)

III. The gains in the value of the capital assets of a legal and beneficial owner, ascertained by conversion as a single isolated event, are not taxable as income under Section 2 (a) or (c) of the Act of 1916-17. 88

A. The words "gains or profits and income derived from any source whatever," in Sec. 2 (a) are insufficient to include the mere increase in the value of capital assets ascertained upon a conversion as a single isolated transaction: 88

Gray v. *Darlington,* 15 Wall. 63.
Lynch v. *Turrish,* 247 U. S. 221.
Towne v. *Eisner,* 245 U. S. 418.

B. The increase in the value of capital assets ascertained upon conversion as a single isolated event, is not included as income in the words "gains,

profits and income derived from * * * sales or dealings in property." 88

1. If "gains or profits and income derived from any source whatever" is insufficient to include an increase in the value of capital assets ascertained by conversion as a single isolated transaction, then the less all-inclusive words "gains, profits and income derived from * * * sales or dealings in property," are equally insufficient to do so.
2. Following *Gray* v. *Darlington*, *Lynch* v. *Turrish* and *Towne* v. *Eisner*, that extraordinary and unusual meanings of "income" are not included in the Act except by very explicit language, the words of Sec. 2 (a), "gains, profits and income derived from * * * sales or dealings in property," must be taken as referring to gains and profits derived from the business of buying and selling capital assets.
3. The Act of 1916-17 in providing for deductions for losses did not permit to be deducted a loss occurring as a result of a single isolated conversion of capital assets.
4. If the statute did cover gains in capital assets ascertained on conversion, the gain in one case might be spread over many years, yet it would be taxed as income in the year of conversion, while another equally large gain occurring in the space of six months, would pay the same tax. If, in order to avoid this, the increase were to be spread over several years and a tax levied on the gain in each year, the act is not constructed to provide for or accomplish any such result.

5. The Act of 1913 contained the same phrase "sales or dealings in property," and yet under *Gray* v. *Darlington* and *Lynch* v. *Turrish*, as well as under the provision of the Act of 1913 as to losses, it must be clear that the words in the Act of 1913 did not assess a tax upon any mere increase in the value of capital assets ascertained on conversion as a single isolated event.

C. It will be argued that Sec. 2 (c) of the Act of 1916-17, which provides that

> "for the purpose of ascertaining the gain derived from the sale or other disposition of property * * * acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived,"

assumes that "sales or dealings in property" as used in Sec. 2 (a) includes a sale or dealing in property which is a mere conversion of capital assets as a single isolated event and that therefore an increase in the value of capital assets so ascertained by a single isolated conversion, was to be taxed as income. There are the following answers to this contention: 9

1. In the Act of 1913 no such clause appeared. Hence, it is clear that the Act of 1913 never included as income an increase in the value of capital assets ascertained by conversion as a single isolated transaction as distinguished from conversions in the course of the business of buying and selling for profit. Hence, in the Act of 1913 "sales, or dealings in property" did not include such an increase in the value of capital assets as income. Hence, the

same words in the Act of 1916-17 would naturally mean the same and should not be given a different meaning by implication from Section 2 (c), if Section 2 (c) can have any other proper and reasonable explanation.

2. Section 2 (c) in the Act of 1916-17 providing for the taking of the value of capital assets as of March 1, 1913, is entirely consistent with an interpretation of the Act which makes "sales, or dealings in property" in Section 2 (a) refer to sales or other dealings in property occurring in the course of a trade or business of buying and selling capital assets for profit.

3. Section 2 (c), if it applies to a conversion of capital assets as a single isolated event, results in incongruity in the case where A purchases stock in 1912 at 67; on March 1, 1913 its value is 14; and then he sells it in 1917 at 65.

IV. The Act of 1916-17 in particular contains no provision for the taxation of any increase in value of the capital assets of a TRUST ESTATE HELD FOR LIFE TENANT AND REMAINDERMEN, ascertained on conversion as a single isolated event. 97

A. Sections 1 and 2 (a) of the Act of 1916-17 define only the taxable income of a legal and beneficial owner or of a person into whose hands an income is actually paid. They do not define as taxable income the increase in the value of capital assets of a trust estate held for a life tenant and remaindermen when such increase is ascertained by conversion as a single isolated event for the purpose of reinvestment: 97

First Trust & Savings Bank, Trustee, v. *Smietanka* (decided at October Term, 1920, Circuit Ct. of Appeals, Seventh Cir.).

B. It is only under Sec. 2 (b) of the Act of 1916-17 that the increase in the value of capital assets ascertained upon conversion by the TRUSTEE can be taxable as income, and that section is insufficient to include such increase in value of the capital assets of the trust estate as taxable income. 102

1. All doubts respecting the scope and meaning of the Act are to be resolved in favor of the taxpayer:

   Gould v. *Gould*, 245 U. S. 151.
   Treat v. *White*, 181 U. S. 264.

2. It cannot be urged that "income" as used in Sec. 2 (b), by reference to Sec. 2 (a), includes every gain to a taxable person described in Sec. 2 (a), for Sec. 2 (a) is describing the income of a "taxable person," *i. e.*, an "individual" who receives an income for his or her own separate use, benefit and disposal. But no such income is involved in a case where the trustee holds the capital of the trust fund for life tenant and remaindermen, especially where the remaindermen are not ascertained until a distant future time.

3. There is nothing in Sec. 2 (b) which provides with sufficient explicitness that the increase in the value of capital assets of a trust estate held for life tenant and remaindermen, ascertained upon conversion by a trustee as a single isolated event for the purpose of reinvestment, shall be income upon which a tax is to be assessed and the trustee held responsible therefor.

   Gray v. *Darlington*, 15 Wall. 63.
   Lynch v. *Turrish*, 247 U. S. 221.
   Towne v. *Eisner*, 245 U. S. 418.

C. Nor can it be inferred from Sec. 2 (c) of the Act of 1916-17 that "the sale or other disposition of property" there referred to, applies to the sale of capital assets by a trustee in the course of administering the trust estate for life tenant and remaindermen and as a single isolated act of conversion and reinvestment. 106

D. It is clear from Sec. 5, subdiv. *Fifth* of the Act of 1916-17 that the trustee cannot deduct losses in capital assets held for life tenant and remaindermen and ascertained by conversion as a single isolated event. This leads to an inference that gains in similar transactions are not to be assessed as income. 107

ARGUMENT.

Part 1.

Assuming (for the Sake of Argument Only) That the Income Tax Act of 1916-17 Attempted to Tax as Income the Increase in Value Since March 1, 1913, or Date of Purchase Subsequent to That Time, of the Stock and Bonds in Question Upon the Ascertainment of the Increment of Value by Conversion or Redemption, the Act Was in Violation of the Constitution of the United States.

I.

THE CONCEPTION OF "INCOME" AS AUTHORITATIVELY STATED BY THIS COURT IN THE SECOND STOCK DIVIDEND CASE.

This court in *Eisner* v. *Macomber*, 252 U. S. 189, at 206, said:

> "For the present purpose we require only a clear definition of the term 'income,' as used in common speech, in order to determine its meaning in the Amendment."

This is sufficient for the purposes of the case at bar also.

This court then proceeded to define "income" as "the gain derived from capital, from labor, or from both combined."

In providing an authoritative gloss for these words the court said (p. 207) (the italics are the court's):

> This means "*not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*,

being *'derived,'* that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; *that* is income derived from property. Nothing else answers the description."

II.

IN ACCORDANCE WITH THE STATEMENT OF THIS COURT LAST ABOVE QUOTED, IT IS NOW SETTLED THAT THE MERE INCREASE IN THE VALUE OF CAPITAL ASSETS (PRIOR TO ANY CONVERSION OR REDEMPTION) IS NOT "INCOME" WITHIN THE MEANING OF THE SIXTEENTH AMENDMENT.

This was the major premise of the stock dividend case of *Eisner* v. *Macomber*, 252 U. S. 189. The court there determined three propositions:

First. A mere "gain *accruing* to capital," or a mere "*growth* or *increment of value in the investment*" was not "income" within the meaning of the Sixteenth Amendment.

Second. Upon an exhaustive analysis of the true nature of a stock dividend the court held that such a dividend represented merely a gain "accruing to capital," or a "growth or increment of value in the investment."

Third. The mere fact that the issuance of a stock dividend may have operated definitely to ascertain the precise increase in value of capital assets did not cause that gain or increase to become "income within the meaning of the Sixteenth Amendment.

In maintaining each of these propositions the court followed its previous decisions.

In holding that a mere "gain accruing to capital" or a mere "growth or increment of value in the investment" was not "income" the court followed *Gray* v. *Darlington*, 15 Wall. 63, 66, and *Lynch* v. *Turrish*, 247 U. S. 221, 231.

In *Gray* v. *Darlington, supra,* the court said:

> "Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as increase of capital."

In *Lynch* v. *Turrish, supra,* the court said:

> "Advance in value is not income at all, but merely increase of capital, and not subject to a tax as income."

The present argument is addressed to a court which we assume is committed to the proposition that *a mere increase in the value of capital assets, unascertained by conversion, is not income within the Sixteenth Amendment.*

III.

THE CONVERSION BY THE TRUSTEE IN THE CASE AT BAR DOES NOT CAUSE THE INCREASE IN THE VALUE OF CAPITAL ASSETS TO BE "INCOME" FOR THE REASON THAT THE INCREASE AFTER THE SINGLE ISOLATED EVENT OF CONVERSION STILL REMAINS CAPITAL JUST THE SAME AS IT WAS BEFORE. THE INCREASE AFTER CONVERSION REMAINED A MERE "GAIN ACCRUING TO CAPITAL," OR "A GROWTH OR INCREMENT OF VALUE IN THE INVESTMENT." IT WAS NOT "SEVERED FROM THE CAPITAL." THE CHANGE IN FORM BY THE CONVERSION DOES NOT MAKE ANY CHANGE IN SUBSTANCE.

A.

This Court, in the case of *Doyle* v. *Mitchell Bros.* 247 U. S. 179, at 185, said:

> "Understanding the term [income] in this natural and obvious sense, it cannot be said *that a conversion of capital assets invariably produces income.* * * * [And, also, at p. 187] When the act [the Corporation Excise Tax Act of 1909] took effect, plaintiff's timber lands, with whatever value they then pos-

sessed, were a part of its capital assets, and *subsequent change of form by conversion into money did not change the essence.*"

If there were only one case where a conversion of capital assets does not produce "income" because the change is merely one of form and not of substance, it must be the one where the conversion is by a trustee for a life tenant and remaindermen and where the result of the conversion is merely the reinvestment of the proceeds as capital of the trust estate. In that case, above all others, the conversion results merely in a change in form and not in substance.

The sale of the stock and the redemption of the bonds for cash in the case at bar operated merely to ascertain the gain in the value of capital assets in dollars and cents. Because, however, the conversion was by a trustee for a life tenant and unascertained remaindermen and was merely incidental to the administration of the trust estate and solely for the purpose of reinvestment, the proceeds of the conversion remained capital and the gain remained a mere increase of capital. The fact that the gain was ascertained in dollars and cents by a sale or redemption did not cause the gain to be any less a mere increase of capital which had not become income.

By the creation of the trusteeship for the benefit of the life tenant and remaindermen the capital in question was not merely the particular stock and bonds held by the trustee, but was the principal of the trust estate in whatever form it might be during the continuance of the trusts—that is to say, whatever was principal of the trust estate at any time, continued to be the principal or capital of the trust estate no matter to what extent its form might have been changed. The fact that the capital or principal of the trust estate is held by a trustee for a life tenant and remaindermen causes the conver-

sion or redemption of capital assets to be of significance only in the matter of ascertaining in cash an apparent gain in capital. It has no effect to cause the gain from the increase in value to become income.

The gain in question was one not "severed from the capital." In the stock dividend case (*Eisner* v. *Macomber, supra*) the gain in the value of the stock, due to an increased surplus of the corporation, was definitely appropriated to capital by the issuance of the stock dividend and therefore was not severed from the capital of the stockholder. Here the capital or principal of the trust estate remains principal and capital as well after as before the sale and redemption in question. What was before appropriated to principal was, after the sale and redemption, equally appropriated to principal.

While the life interest continued, the increase in the value of capital assets was additional capital on which *the life tenant was entitled to the annual product.* When, therefore, the Government took part of that capital to satisfy an income tax, it was actually taking not only the capital of the trust estate in general, but in particular, *the capital of the life tenant*—the capital in which she was interested as life tenant and which as to her especially, was capital and nothing else—and which as to her remained capital during her life.

In the stock dividend case (*Eisner* v. *Macomber, supra*) there clearly occurred a gain in the value of the stockholder's capital assets, *namely,* his stock. But the issuance of the stock dividend left that increase still a capital asset and no "income" resulted. So, in the case at bar, the conversion and redemption leaves the proceeds still part of the capital assets of the trust estate precisely as it was before.

B.

Eisner v. *Macomber, supra* (the stock dividend case), came up from New York State, where as between life tenant and remainderman the stock dividend is primarily regarded as distributable to the life tenant so far as it represents earnings of the corporation which accrued while the stock was held and since the trust commenced. In so holding the New York courts followed what is known as the Pennsylvania rule, which (as Mr. Justice Brandeis in his dissenting opinion in *Eisner* v. *Macomber,* 252 U. S. 189, 235, said), has been adopted

> "by so many of the States (including New York and California), that it has come to be known as the 'American Rule.' "

Yet such a state of decisions was plainly immaterial when the question of the taxability of the stock dividend as income under the Sixteenth Amendment arose. The reason is that the stock dividend, though not income at all, may still, according to an expressed intent of the creator of the trust, or an assumed intent founded upon equitable considerations, be paid wholly or in part to a life tenant. The American cases which require that result merely hold that primarily at least, such an intent is expressed, or assumed to be expressed. It follows that cases which hold a stock dividend distributable wholly or in part to a life tenant are merely decisions that an intent has been expressed, or is assumed to have been expressed, by the creator of the trust, that *that part of the capital of the trust estate in the shape of a stock dividend is to be distributed to the life tenant,* who then receives it as a distribution of a capital asset. Innumerable decisions to this effect are of no consequence in the determination of whether a stock dividend is income within the Sixteenth Amendment. That must be determined exclusively upon the essential nature of the

stock dividend and not upon whether a testator or settlor expressed his intent, or was assumed to express an intent, that the capital of the trust estate in the shape of a stock dividend, should be distributed to the life tenant.

On the other hand, a single case which reaches a conclusion that primarily at least the gift of income to the life tenant does not include a stock dividend, because upon a sound analysis of what a stock dividend really is, it cannot be said to be income, is of vital and controlling effect in determining what is income within the Sixteenth Amendment. Hence, in *Eisner* v. *Macomber, supra,* one case, *namely, Gibbons* v. *Mahon,* 136 U. S. 549, which decided, upon a sound analysis of the nature of a stock dividend, that it was capital and for that reason was primarily not income in a gift of income to a life tenant, was of more weight than any number of cases holding that a stock dividend primarily went to the life tenant.

So it is with the increase in the value of stock as a capital asset of a trust estate held for life tenant and remaindermen and ascertained upon conversion. One or more cases deciding, upon a sound analysis of the nature of such an increase, that it is capital and not income and for that reason is primarily not distributable to a life tenant entitled only to income, is of decisive importance in determining whether the increase in value is income within the Sixteenth Amendment. The following are such cases:

Smith v. *Hooper,* 95 Md. 16, 26-31, where the court said:

> " 'The word "income" has a broader meaning, but hardly broad enough to include things not separated in some way from the principal. It is not synonymous with "increase." The value of stock may be increased by good management, prospects

of business, and the like. But such increase is not income. It may also be increased by an accumulation of surplus; but so long as that surplus is retained by the corporation, either as surplus or increased stock, it can, in no proper sense be called "income." It may become producing, but it is not income.' *Spooner* v. *Phillips*, 62 Conn. 62 (24 Atl. Rep. 524.) Surplus and accumulated reserve funds until set apart and appropriated by the corporation for the payment of dividends are capital, and whatever their magnitude may be, they are not, as between life tenant and remainderman, treated as income until they are distributed. *Gibbons* v. *Mahon*, 136 U. S. 549. * * *. Whatever the actual causes may have been the fact is that the shares of stock have grown enormously in value and the things that have given them that value inhere in them still, since they have not been separated from them by any act of the corporation. There has been no segregation from the shares, of any of the elements which make up the value of the shares and until there is such a segregation all of those elements belong to the shares and pass with the latter when sold. *The conversion of some of the shares into money resulted merely in substituting the cash received for the shares thus sold; and if the unsold shares represented nothing but capital, though capital of a largely increased value, the money obtained for the same shares when sold can represent nothing but capital either.* * * * That there has been a marvelous *increase* of the fund is manifest. Is that increase *income?* Increase and income are not synonymous terms. Until detached or separated from the shares whose value it enhances, increase forms part of that value, and, therefore, part of the shares; and if it be part of the shares themselves then, whilst it may be *profit*, it is in in no sense income. * * * If the value of such shares in which the trustees have invested the trust fund, consists in part of accumulated surplus or undivided earnings, the additional value is part of the capital and together with the par value of the shares must be kept intact for the benefit of the remainderman. * * * Inasmuch, then, as whatever of value there

is in the shares of stock in which the original trust fund was invested and reinvested is, so far as the record discloses, inherent in the stock itself and has not been segregated from the stock in any way; it must be held to form part of the trust fund, and, therefore, to belong to the trustees and not to the *cestui que trust*, except as hereinafter indicated."

Stewart v. *Phelps*, 71 App. Div. (N. Y.) 91 (affirmed 173 N. Y. 621). The Appellate Division said (p. 96):

"This discretion as to the character of the securities in which the trust property was to be invested did not either expressly or by implication relate to the question as to what should be income and what principal. It is still an investment of the trust fund that the trustees are required to make. In investments of this character there is always a possibility of *loss* as well as gain, and it is contrary to that purpose for which a trust fund is created to allow an increase in the value of the securities in which the fund is invested to be paid to the living beneficiary, where no provision is made for such a repayment in the event of any loss which may be sustained by reason of unfortunate investments. It cannot be claimed that, had there been a decrease in the value of the securities turned over by the executors to the trustees as part of this trust estate, the life beneficiary would be liable to make good to the estate a loss; nor could it be claimed that, had the trustees made investments that turned out disastrously to this estate, the life beneficiary would be bound to make good a depreciation in the value of the securities in which the fund had been invested. That the investments of this estate have shown a remarkable increase in value, and that the trustees by wise and judicious management have increased the value of the estate by reason of investments that they have made, would not justify the court, without the explicit direction of the testator, in decreeing that such an increase be paid to the living beneficiary, when the future may show a depreciation in the value of other securities in which the trust estate is invested and which would deplete the trust which it was evidently the intention of the testator should

be preserved for the benefit of his daughter during her life, and for the benefit of her children and the other members of his family after her death."

See, also,

Guthrie's Trustee v. *Akers*, 157 Ky. 649.
Boardman v. *Mansfield*, 79 Conn. 634.
Connolly's Estate, 198 Pa. St. 137.
Re Kemble's Estate, 201 Pa. St. 523; 51 Atl. 310.
Matter of Kernochan, 104 N. Y. 618 (point "Second," p. 625).

Similarly, where there is a partial or complete liquidation of the assets of the corporation, the payments made, even with assets arising from accumulated earnings, are distributions of capital and primarily at least not distributable to the life tenant to whom only the income has been given.

In re Armitage [1893], 3 Ch. 337, Lindley, L. J., said:

"In this case I do not feel much difficulty. * * * The question we have to determine is, who is entitled to the sum of £1 5s. 6½d. per share upon 4,450 shares which belonged to the estate of the testator, those shares being shares in a company which was wound up and reconstructed? We must first look at the testator's will. * * * The short effect of that will is this—one-third part of these shares is held by trustees upon trust to pay the income to the tenant for life and subject thereto in trust for the remainderman. Now, is this £1 5s. 6½d. income within the meaning of that trust? How does this £1 5s. 6½d. per share arise? It arises in this way. The shares were £10 shares with £8 paid up upon them. The company was wound up and the assets of the company were distributed amongst the registered shareholders, and each registered shareholder got £9 5s. 6½d. instead of £8—that is to say, upon the distribution of the assets, there was an excess of £1 5s. 6½d. whether profits or capital I will not at present say, over the £8 paid up in respect of each share. It arose apparently in this way. The assets

of the company consisted among other things of about £20,000 standing to a reserved dividend fund, and of £17,000 standing in the books of the company and representing undivided profits in addition to the reserved dividend fund. Those undivided profits, of course, could have been divided as dividends if the company had so thought fit. The £20,000 was applicable to the equalization of dividends. The moment the company got into liquidation there was an end of all power of declaring dividends and of equalizing dividends, and the only thing that the liquidator had to do was to turn the assets into money, and divide the money among the shareholders in proportion to their shares. That is what he had done.

Now, there has been a great discussion about the nature of this £1 5s. 6½d. as to whether it is capital or income, and whether it is profit. I should say it is profit. When a person gets out of a concern more than he puts into it the difference is profit. If I put £100 into a concern and get out £105, I get £5 profit. In that sense of the word, this £1 5s. 6½d. is profit, being the excess of the money produced by the sale of the investment over the amount of money invested. But is it income to which the tenant for life is entitled? That is a totally different matter, and I say that it clearly is not. What does a man mean when he leaves shares to a tenant for life? He means that that tenant for life shall have the income arising from the shares in the shape of dividends or bonuses declared during the lifetime of the tenant for life. He does not mean that the tenant for life shall receive profits in any other sense. He does not mean him to have such profits for example, as arise by a realization of shares; he never dreamed of such profits going to the tenant for life. What he means is, that the tenant for life shall have the income derived from the dividends or bonuses declared by the company; and when you ask me whether this £1 5s. 6½d. is income payable to the tenant for life, it seems to me as plain as possible that it is not, although it is profit in the sense I have just explained. * * * It is true that this property has never been capitalized by the company, neither has it ever been declared as a dividend or

bonus by the company; the company has not dealt with it in either one shape or another. But when you come to ask yourself whether it is to go to the tenant for life or to the remainderman, there can be but one answer—it is to go to the remainderman."

Bulkeley v. *Worthington Society*, 78 Conn. 526, 532:

"It is universally true that surplus earnings do not, as to stockholders, partake of the character of income until they are declared as dividends, and whether they will ever be so declared is a matter of uncertainty, since, speaking generally, they may in the discretion of the directors, although not capitalized, be forever retained in the corporation to serve as a part of its working capital. In this State and elsewhere it is only to surplus earnings declared in cash that the character of income attaches, and through the medium of stock dividends they may go to capital and permanently inure to the benefit of that interest. *Smith* v. *Dana*, 77 Conn. 543; *Gibbons* v. *Mahon*, 136 U. S. 549. In other words, the question whether corporate earnings are, from the standpoint of the shareowners, to be regarded as income, depends not only upon their being surplus earnings, but also upon the action of the corporation in setting them apart for the shareowners, and the nature of that action. The rule, therefore, which says that whatever of assets are to be regarded as income must be so declared by corporate action before liquidation proceedings, and, for the purposes of distribution in liquidation, treats as belonging to the capital interest all such assets as by the action of the directors during the continuance of the corporation as a going concern have not been aparted from the general body of assets and set out to stockholders, is neither unreasonable nor essentially unjust. It is a rule which accepts the situation as it was created by those empowered to so create it, and does not attempt to revolutionize it along new lines and by new agencies."

See, also,

Wilberding v. *Miller*, 88 Oh. St. 609 (for full report of opinion see 106 N. E. 665.)

Even where a state court is committed to the apportionment of a stock dividend between life tenant and remaindermen according to what has been called the Pennsylvania Rule (referred to by Mr. Justice Brandeis in *Eisner* v. *Macomber*, 252 U. S. 189, 235), the mere increase in the value of stock, ascertained on conversion by a trustee for life tenant and remaindermen, has been held to be capital and not income and therefore not primarily distributable to the life tenant.

Re Kemble's Estate, 201 Pa. St. 523.
Connolly's Estate, 198 Pa. St. 137.
Re Graham's Estate, 198 Pa. St. 216.
Re McKeown's Estate, 106 Atl. 189 (Pa. 1919).
Thayer v. *Burr*, 201 N. Y. 155 (case of winding up corporation and distribution of assets).
Re Stevens, 98 N. Y. Supp. 28 (187 N. Y. 471) (case of corporation winding up).
Stewart v. *Phelps*, 71 App. Div. 91 (affirmed 173 N. Y. 621).

Even if the *dicta* in some of the foregoing cases seem to support a rule that the mere increase in the value of stock, ascertained on conversion by a trustee for life tenant and remaindermen, when affirmatively shown to be the result of earnings of the corporation since the life estate commenced and held by the corporation in such liquid form as to be available for dividends, is distributable to the life tenant, yet such a rule is to be supported (if at all) *not* on the ground that the gain is income, but *in spite of the fact that it is capital.* Under such a rule the increment of value is distributed to the life tenant because of an expressed intent of the creator of the trusts, based upon surrounding circumstances, or upon an assumed intent founded upon equitable considerations. This court recognized that this was the true ground

for such a ruling, because in *Towne* v. *Eisner*, 245 U. S. 418, and *Eisner* v. *Macomber*, 252 U. S. 189, it ignored as irrelevant on the question of whether a stock dividend was income, decisions of state courts apportioning stock dividends between life tenant and remaindermen.

Some cases have intimated that a special context which provides that the life tenant shall have not only the "income," but also something in addition thereto and described as "gains," or "profits," may be effective to require an increase in the value of stock ascertained by conversion, to be distributable to the life tenant.

U. S. Trust Co. v. *Heye*, 224 N. Y. 242, 253, 254:

> "It is to be presumed that the settlor meant to indicate by the use of the words 'income' and 'profits' pretty much everything in the way of advantage or benefit which might accrue from the stock without decreasing the original value of the capital which it represented."

Smith v. *Hooper*, 95 Md. 16, 30:

> "If, by the terms of Mr. Hooper's will, the life tenant had been given not only the dividends and income, but also the *profits* arising from an investment of the trust fund, a different question might and probably would have been presented."

In the case at bar, it is clear that the increase in value of the stock in question could not, under the decisions of any state, go to the life tenant, but must remain a part of the capital assets of the trust estate until the termination of the trusts and then, if it still continues to exist in the hands of the trustee, it must be distributed to the remainderman. The will of Arthur Ryerson in the case at bar, creating the trust in question, expressly provides:

> "My trustees shall be the final judges as to what net income is, and their determination in this respect shall bind all parties interested in my estate, except that it is my will that stock dividends and

accretions of selling values shall be considered principal and not income."

Under such a provision no part of the proceeds on conversion of the stock in question could be distributed to the life tenant under any known doctrine prevailing in any jurisdiction.

When the securities of the trust estate on which a profit is realized by sale or redemption are *bonds*, the increase in value is always due, or at least assumed to be due, merely to market conditions or to redemption premiums fixed in advance and not at all to any surplus earnings which might be dividends or income if they were declared. Hence, in the case of an increase in the value of bonds, it is believed to be universally recognized that the increase in value, ascertained on conversion or redemption, primarily belongs to the capital of the trust estate as between life tenant and remainderman:

Re Graham's Estate, 198 Pa. St. 216.

Matter of Gerry, 193 N. Y. 445.

Devenney v. *Devenney*, 74 Oh. St. 96 (77 N. E. 688).

Whittingham v. *Scofield's Trustee*, 67 S. W. 846 (Ky.).

This should be noted because in the case at bar the question is raised whether the redemption price paid upon the calling of the bonds of the trust estate can be regarded as income within the meaning of the Sixteenth Amendment.

C.

In view of the above cases and the long-continued "common understanding" in accordance with the results reached by them, we submit that the reasoning of the dissenting opinion of Mr. Justice Holmes, in which Mr.

Justice Day concurred, in the stock dividend case (*Eisner, v. Macomber*, 252 U. S. 189) would result in holding unconstitutional an act which attempted to tax as income the increase in the value of the capital assets of a trust estate held for life tenant and remaindermen and reduced to dollars and cents by conversion as a single isolated transaction and only for the purpose of reinvestment as capital assets of the trust estate. In the dissenting opinion referred to it is said (pp. 219-220):

> "I think that the word 'incomes,' in the Sixteenth Amendment should be read in 'a sense most obvious to the common understanding at the time of its adoption.' *Bishop v. State*, 149 Indiana, 223, 230; *State* v. *Butler*, 70 Florida, 102, 133. For it was for public opinion that it was proposed. *McCulloch* v. *Maryland*, 4 Wheat. 316, 407. The known purpose of the Amendment was to get rid of nice questions as to what might be direct taxes, and I cannot doubt that most people not lawyers would suppose when they voted for it that they put a question like the present to rest."

We submit that according to the "common understanding" at the time of the adoption of the Sixteenth Amendment, an increase in the value of the capital assets of a trust estate held for a life tenant and remaindermen and ascertained upon conversion, as a single isolated event, for the sole purpose of reinvestment by the trustee, resulted in a gain which was not income for anyone, but remained part of the capital of the trust estate.

We submit that "most people not lawyers would not suppose when they voted for" the Sixteenth Amendment that they had put to rest the question whether an increase in the value of the capital assets of a trust estate held for life tenant and remaindermen and ascertained by conversion, as a single isolated event, was income as distinguished from capital, because no such question existed.

It occurs to us that with respect to a stock dividend there may have been a current popular belief and common understanding that it was as much a dividend as a corporation cash dividend and that the evidence of such common understanding lay in the very fact that it was referred to as a "dividend." But whoever called an *increase in the value of capital assets of a trust estate consisting of stock held for life tenant and remaindermen* a *dividend* or income for any person? Whoever thought of it as a dividend or as income? Is it not an indubitable and ineluctable fact that it has always been regarded, both in the use of descriptive language and in thought, as precisely what it is, *namely, an increase in the value of capital assets*, remaining capital assets though ascertained by conversion, and continuing to be capital assets as distinguished from income?

D.

In the stock dividend case (*Eisner* v. *Macomber*, *supra*), this court, after pointing out that the recipient of the stock dividend, unless possessed of other resources, had not, without selling, the wherewithal to pay the income tax on the stock dividend, said (p. 213):

> "Nothing could more clearly show that to tax a stock dividend is to tax capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax."

If we apply the same test in the case at bar, it will be observed that in order to pay the tax on the increase in value of the stock and bonds the trustee must take part of the capital assets of the estate. The trustee must even convert capital assets of the trust estate in order to pay the tax. When the proceeds of the sale are received it is the duty of the trustee to invest them

at once as part of the capital of the trust estate held for the benefit of the life tenant. At a subsequent time, when the tax becomes due, the trustee must convert this capital, or other capital assets, to raise the funds with which to pay the tax.

At least during the continuance of the life estate the increase in the value of the capital assets in the case at bar remained capital so far as the life tenant was concerned. The life tenant is entitled to have her income determined on the basis of a return on the increase in the value of the capital assets as capital, whether the same have been converted or not. An income tax which can only be paid by taking part of that increase, which is capital for the life tenant and on which the life tenant is entitled to the return as income from the investment, is certainly a taking of capital to pay the income tax. It is more reprehensible than that, for it is a taking of the capital of the life tenant to pay an income tax upon a gain which may or may not come to the hands of the remaindermen.

E.

The government's position that the increase in the value of the capital assets of the trust estate in the case at bar is taxable income may be tested by reversing the relations of the parties.

Suppose the statute provided that the net income to be taxed was to be ascertained by deducting from gross income (except increases in the value of capital assets ascertained by conversion, as in the case at bar) "all *losses in transactions in which a gain, if it occurred, would be income within the Sixteenth Amendment.*"

Suppose when losses occurred to corporate capital the corporation were accustomed to issue reductions of capi-

tal stock just as when they make gains they issue stock dividends, would the government under the statute supposed ever have contended that these were losses to be deducted in arriving at net income? Would any taxpayer have had the temerity to contend in this court that the *minus* stock dividend could be deducted as a loss because the *plus* stock dividend would have been income?

Suppose under the statute assumed the trustee in a given year suffers a loss in capital, as the result of conversion, equal to the conceded income of the trust estate payable to the life tenant. Then suppose the trustee contended that he could deduct the loss so as to wipe out all the income so that no tax was payable, and suppose he further contended that as between the life tenant and remaindermen the loss must fall on the capital of the trust estate, so that the life tenant was entitled to the full income actually produced and that such income was free from any income tax because that tax had been eliminated by the deduction due to a loss in capital.

Can it be imagined that the government would accept such a result? Counsel for the taxpayer would hardly be able seriously to present such reasoning to the court. The judgment of the court would, it is submitted, be that the loss was a *loss to capital*—a loss in a transaction which could only have resulted in a gain to capital and which could not therefore be income within the Sixteenth Amendment; that the loss, therefore, could not be deducted; that a loss in capital could not be used to reduce an actual income for the purpose of taxation, leaving the income to be paid a life tenant free of any income tax.

IV.

THE CONVERSION AND REDEMPTION IN THE CASE AT BAR DO NOT CAUSE THE INCREASE IN THE VALUE OF CAPITAL ASSETS OF THE TRUST ESTATE TO BE INCOME BECAUSE THE GAIN OR INCREASE HAS NOT BEEN "'DERIVED,' THAT IS, RECEIVED OR DRAWN BY THE RECIPIENT (THE TAXPAYER) FOR HIS SEPARATE USE, BENEFIT AND DISPOSAL."

A.

When the trustee for a life tenant and remaindermen sells a capital asset of the trust estate, the increase in value, if any, is not "derived," "received" or "drawn by" anyone for "his separate use, benefit and disposal." It does not come to the TRUSTEE for his separate use, benefit and disposal. It comes to the trustee only as capital which he must reinvest and retain as capital. It is not received in any respect by the LIFE TENANT, much less for the separate use, benefit and disposal of the life tenant. It is not "derived," "received" or "drawn by" the REMAINDERMEN in any sense. Much less is it derived, received or drawn by any remainderman "for his separate use, benefit and disposal."

In the stock dividend case (*Eisner* v. *Macomber, supra*) the Government contended

> "that the new certificates measure the extent to which the gains accumulated by the corporation have made him the richer."

To this the Court replied that there was an insuperable difficulty for the reason that

> "it would depend upon how long he had held the stock whether the stock dividend indicated the extent to which he had been enriched by the operations of the company; unless he had held it through-

out such operations the measure would not hold true."

In the same way, in the case at bar, we are entitled to consider various situations which might be presented and which emphasize the fact that the gain in the case at bar has not been derived, received or drawn by anyone for his separate use, benefit and disposal.

(1) In the stock dividend case the court pointed out that the stockholder *might not have received* the gain indicated by the stock dividend. In the case at bar we point out that the gain *may never be received by anyone.* No beneficiary has yet received it; none may ever receive it because losses may occur and the gain be wiped out.

(2) The difficulty of calling the increase in the value of capital assets, ascertained on conversion, as in the case at bar, taxable income, is apparent when the deduction due to losses in the same capital assets is attempted. In the case at bar the life tenant receives all the net income (which, however, does not include any increase in the value of capital assets). Suppose the next year a considerable loss occurs, which is ascertained upon the conversion of a capital asset, how could it be deducted? The trustee could not deduct it from the income received so as to reduce the tax, because that would load the loss in capital assets upon the life tenant and while she might pay no income tax, she would also receive no income, because her income had been used to make good a loss in capital assets. But if the trustee does not deduct the loss from the income received and to be paid the life tenant, the trustee has no income from which to deduct the loss and thereby arrive at an income subject to taxation. The trustee certainly could not deduct the loss from the income received so as to avoid the tax and then pay the whole income re-

ceived over to the life tenant with the income tax paid. The Government would say at once in that case that the loss on capital assets was being used to reduce an income for the purpose of avoiding the tax, while the actual loss was carried, as between the life tenant and remaindermen, as a loss to the capital account. These difficulties only illustrate the incongruities and inconsistencies into which one is plunged when he begins to call an increase in capital "income," and conversely, losses in capital deductible in order to ascertain a net income.

When an increase in the value of capital assets occurs, the Government is quite clear that it is an income and taxable. It has no compunction about adding the increase to an actual income so as to increase the income. But reverse the process and let a trustee attempt to deduct a real loss in capital assets from an actual income to ascertain a net taxable income and the Government will be quick to recognize the loss as a loss in capital assets, unrelated to income and not deductible for the purpose of ascertaining income. In such a position it clearly admits the distinction contended for between the capital assets of the trust estate and the income.

(3) Suppose now, that the gain in the capital assets of the trust estate is ultimately received by the remaindermen and suppose (for the sake of argument only) it were regarded as income in their hands. In that case the remaindermen might be so numerous that upon a division of the increase among them as income, they would pay only the normal tax. It would be incongruous under such circumstances for the trustee to have already paid a tax upon the entire increase in the value of the capital assets as if the increase were a gain re-

ceived by a single taxable person for his separate use, benefit and disposal.

B.

That an increase in the value of capital assets, even though ascertained by conversion, cannot be "income" so long as it is not derived, received or drawn by anyone for his separate use, benefit and disposal, is made clear by the stock dividend case (*Eisner* v. *Macomber*, 252 U. S. 189, 207).

The court there said, as already quoted, that the gain to be income must be

> " 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal,—that is, income derived from property. Nothing else answers the description."

This was applied as the very basis for the decision. In that case there was a gain in the value of the capital assets represented by the stockholder's stock. But it was a mere increase in the value of such capital assets. The increase was never "derived," "received" or "drawn by" the stockholder, in the sense that it was paid into his hands for his separate use, benefit and disposal. It was an increase which remained, after the stock dividend, as before, a mere increase in the value of capital assets reflected only in the value of the total amount of stock held by the stockholder. So, in the case at bar, there has been a gain in the value of the capital assets of the trust estate, but it has not been derived, received or drawn by anyone for his separate use, benefit and disposal. It continues to be part of the capital of the trust estate just as it was before and remains merely an increase in the value of capital assets just as did the surplus of the corporation appropriated to capital in the case of the stock dividend.

In the stock dividend case (*Eisner* v. *Macomber, supra*) Mr. Justice Brandeis insisted that whether a stock dividend was declared or a cash dividend with an option to apply the cash dividend on the payment of new stock to be issued, was merely a matter of form and if the cash dividend in the latter case was taxable as income, then the stock dividend alone should be. To this the majority of the court replied that there was a real and substantial difference in the two dividends, because in the case of the cash dividend the stockholder had an absolute right *to do with the cash dividend what he pleased.* He could take the cash and refuse to subscribe for the new stock; while in the case of the stock dividend pure and simple, the stockholder had no choice, but was compelled to accept, whether he wanted to or not, the appropriation of the corporate surplus permanently to capital. The court said (p. 215):

> "It is said there is no difference in principle between a simple stock dividend and a case where stockholders use money received as cash dividends to purchase additional stock contemporaneously issued by the corporation. But *an actual cash dividend, with a real option to the stockholder either to keep the money for his own or to reinvest it in new shares, would be as far removed as possible from a true stock dividend,* such as the one we have under consideration, where nothing of value is taken from the company's assets and transferred to the individual ownership of the several stockholders and thereby subjected to their disposal."

This indicates the vital importance of there being a gain which is received "for his separate use, benefit and disposal" as distinguished from a gain which has not been so received by any person for his separate use, benefit and disposal, but still remains a mere increase in the value of a capital asset.

The same distinction obtains between the case of a gain

by a trustee for life tenants and remaindermen from the sale of capital assets and the gain by a legal and beneficial owner of capital assets. The legal and beneficial owner has a right to take the gain in cash and do with it what he pleases. In the case of the trustee the gain in cash must be handled as capital of the trust estate and reinvested. It does not come within the discretion of any beneficial owner to do with as he pleases.

C.

It may be urged that a direction to a trustee to accumulate rents, interest, dividends and profits from a business and to add them to principal and ultimately pay them over to persons not yet ascertained, would, nevertheless, be taxable under the Sixteenth Amendment. If this be so it does not in any way minimize the requirement that an increase in the value of capital assets ascertained on conversion to be income must, upon the conversion, be derived, received or drawn by someone for his separate use, benefit and disposal.

Gains proceeding from capital, such as rents, interest, dividends and the profits of a business, which are admittedly income, do not CEASE to be income because they are not payable at once to the beneficiary who is ultimately to have the use, benefit and disposal of them. When, however, the question is whether an increase in the value of a capital asset, which before conversion is admittedly not income, but capital, becomes by conversion income, it is essential that the person taxed shall have converted a capital investment *belonging to him*, as a result of which he receives an actual gain for his separate use, benefit and disposal. The receipt of the gain by a trustee for life tenant and remaindermen, who takes it, not for his separate use and disposal, but as capital of the trust

estate, and who has paid nothing for it so that there is no *cost* to him upon which to base any actual profit, leaves the increase in value, ascertained by conversion, far short of producing "income"—according to any authoritative usage or common understanding of the meaning of that word.

In the stock dividend case this court was considering whether *an addition to corporate capital,* which was admittedly a mere *increase in the value of the capital assets of the stockholder,* became income by the issuance of a stock dividend. When, therefore, it said that to be income the gain must be " 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal," it emphasized that requirement *for the case where the question was whether a mere gain in the value of the capital assets* (admittedly not income) became such income by reason of the gain being ascertained. That means that when there occurs an increase in the value of capital assets of a trust estate, as in the case at bar, and the question is whether this increase, which by itself is admittedly not income, becomes income when ascertained by conversion, it is equally proper and necessary to inquire whether the gain is one which has been "derived," "received," or "drawn by" anyone for "his separate use, benefit and disposal."

D.

In the stock dividend case (*Eisner* v. *Macomber, supra*), the Court said, 211:

> "The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of

> the company, still remains the property of the company, and *subject to business risks which may result in wiping out the entire investment.* Having regard to the very truth of the matter, to the substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment."

This was evidently said in reply to the contention of the Government that, looking at the substance and not the form, the stockholder was a contributor to a business enterprise and when surplus earnings were appropriated to stockholders, the gain was in fact realized for them by reason of the permanent appropriation of such earnings to capital; that the right of the Government to tax was not to be made dependent upon the fact that a mere corporate form stood between the fund so appropriated to stockholders and the stockholders themselves. Such an argument this Court repudiated because it would have amounted to the substitution of a *fictitious* for an *actual* realization of the gain by the stockholder. The corporate form was used *bona fide* and it was a usual and proper method in use in conducting business. The interposition of that form between the gain and the stockholder was properly to be considered in determining whether the gain was actually realized by the stockholder for his separate use, benefit and disposal, or not.

So in the case at bar, the trusteeship was *bona fide.* It was created prior to the Income Tax Amendment. It is a customary and proper arrangement for testators to make and quite as well recognized as the corporate form in business. If, as a result of the *bona fide* use of a trusteeship, a gain, which is admittedly a mere accession to principal, is not actually realized—that is, is not "derived," "received" or "drawn by" anyone "for his separate use, benefit and disposal," and may never

be so realized because the gain may be wiped out by subsequent losses, full effect must be given to that fact in determining whether the gain is income for the purposes of taxation.

V.

IN THE CASE OF A TRUSTEE WHO CONVERTS A CAPITAL ASSET WHICH HE HAS RECEIVED BY DEVISE, THERE CAN BE NO PROFIT OR GAIN UPON WHICH TO BASE ANY CLAIM OF INCOME.

It is conceded that a mere increment of value of the capital assets of a trust estate prior to any conversion is not income, but capital. The contention is that the gain prior to conversion is merely fictitious until it has been realized by conversion. In the same way, to secure an actual, as distinguished from a fictitious, profit, there must be a purchase for cash—*something at the beginning of the transaction which corresponds to a conversion at the end.* Otherwise, the beginning of the transaction is fictitious and not real. In the case at bar, where the trustee received the stock in question by devise, there is no purchase or other act at the beginning of the transaction with which the selling price may be compared to ascertain a gain. There is no outgo. So far as the stock in the case at bar is concerned all that can be said is that the trustee received a certain capital asset for which it paid nothing—on which there was no outgo—and later it sold that capital asset. There is no realized gain at all, because one of the necessary factors for a realized gain—*namely*, an actual outgo or cost to begin with—is entirely absent.

The force of the foregoing proposition is even more apparent when it is observed that there cannot be any

actual *loss* under the same circumstances. There being no cost or outgo at the commencement of the transaction, there is nothing with which to compare the selling price to ascertain an actual loss. In short, an actual gain or loss is dependent not only on a conversion at the end of the transaction, but on the actual outgo or cost at the beginning.

VI.

EVEN, HOWEVER, WHERE THE LEGAL AND BENEFICIAL OWNER OF CAPITAL ASSETS SELLS THEM AT A PROFIT AS A SINGLE ISOLATED TRANSACTION (HE NOT BEING IN ANY SENSE IN THE BUSINESS OF BUYING AND SELLING FOR PROFIT) THE GAIN IS NOT INCOME WITHIN THE SIXTEENTH AMENDMENT.

A.

It is now settled that the mere increase in the value of capital assets is not income prior to the conversion of such assets and the definite ascertainment in cash of the gain. This is the purport of the stock dividend case (*Eisner* v. *Macomber, supra*) and other cases cited, *ante*, I, B.

If, therefore, any income arises by reason of a gain in the value of capital assets, it must so arise solely by reason of the *mere conversion* into cash of capital assets.

B.

Again, we say that a conversion, as a *single isolated event*, leaves the proceeds of the capital assets just as much capital assets as was the property prior to conversion. The increase in the value of the capital assets is just as much a mere increase in such value after it is ascertained by conversion in dollars and cents as it was when ascertained by calculation prior to a conversion.

These questions may be asked: Why is not a gain in the value of capital assets, when realized by conversion as a single isolated event, income? Is it not a gain which has come to hand? Why is a line drawn between gains realized by conversion in a business of buying and selling and a gain realized by conversion as a single isolated event?

The short answer is that by clear and authoritative *usage* and *common understanding*, the word "income" does not include the latter.

It is difficult to prove a negative. Nevertheless, in support of the foregoing statement there is direct evidence in (1) the judicial rulings that a gain ascertained on conversion as a single isolated event is not income and, therefore, is not primarily distributable to a life tenant entitled to income, as against a remainderman entitled to capital (*ante*, pp. 29-37); (2) the decisions under the British Income Tax Act (*post*, pp. 68-70); (3) the statement of this Court in *Gray* v. *Darlington*, 15 Wall. 63, approved and repeated in *Lynch* v. *Turrish*, 247 U. S. 221, to the effect that:

> "The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as increase of capital."

The inherent difficulty in proving a negative challenges the Government to produce evidence of an authoritative usage and common understanding under which income includes a gain in the value of capital assets ascertained on conversion as a single isolated event.

But the inquiry may be made even more searching. Why should authoritative usage and common understand-

ing exclude such a gain from the meaning and scope of income?

Two obvious reasons are presented:

First. The human mind which habitually and (as this Court has held) properly views the mere increase in the value of a capital asset before conversion as capital and not income, naturally does not, and in fact has not, upon conversion as a single isolated event, changed its outlook, but continues to view the proceeds of the conversion as precisely the same asset in another form, as existed before the conversion. When a court says, as it did in *Smith* v. *Hooper* (95 Md. 16, 26-31, *ante*, pp. 30-32), that:

> "The conversion of some of the shares into money resulted merely in substituting the cash received for the shares thus sold; and if the unsold shares represented nothing but capital, though capital of a largely increased value, the money obtained for the same shares when sold can represent nothing but capital either,"

it is merely testifying to the fact that the human mind, in its usual and common operations, does not change its view that a given asset is capital merely because, as an isolated event of conversion its form may have been changed.

Second. "Income" is definitely associated in authoritative usage and common understanding with the idea of a "recurrence of the gain," or the coming in of the gain "within a specified time, or regularly (when unqualified, annually)" or "periodically." This is sustained by the leading dictionaries, which are here used as evidence of authoritative usage and common understanding.

In Webster's New International Dictionary under the title "Income" 4, income is defined as

> "That gain or *recurrent* benefit (usually measured

in money) which proceeds from labor, business or property," etc.

In Funk & Wagnalls' New Standard Dictionary, under the title "Income" 1, the word is defined as

> "The amount of money coming to a person or corporation *within a specified time, or regularly* (when unqualified, annually)," etc.

In the New English Dictionary, under the title "Income" 6, the definition given is

> "That which comes in as the *periodical* produce of one's work, business, lands or investments (considered in reference to its amount, and commonly expressed in terms of money); annual or *periodical* receipts accruing to a person or corporation; revenue."

The human mind does not recognize, in a gain realized by a conversion, as an isolated event, a gain of *recurrent* character, or a gain coming in *within a specified time*, or *regularly*, or *periodically*. This Court in *Gray* v. *Darlington*, *supra*, recognized that such an essential element in the idea of income was lacking. Just after the statement above quoted from the opinion of the Court, it went on to point out as follows:

> "The rule adopted by the officers of the revenue in the present case would justify them in treating as gains of one year the increase in the value of property extending *through any number of years, through even the entire century.* The actual advance in value of property over its cost may, in fact, *reach its height years before its sale; the value of the property may, in truth, be less at the time of the sale than at any previous period in ten years*, yet, if the amount received exceed the actual cost of the property, the excess is to be treated, according to their views, as gains of the owner for the year in which the sale takes place."

Thus, the court saw clearly why it was that authoritative usage and common understanding of the word "in-

come" excluded from it a gain ascertained by conversion as an isolated transaction. Because such a gain may be spread over a number of years; because it may be realized after great fluctuations over a number of years, and because it may be the only gain in that sort of transaction ever realized, it lacks the element of "recurrence" or of "coming in within a specified time," or "regularly," or "periodically."

This Court should pause before it lightly assumes and adopts a meaning of "income" which would violate so much evidence of an authoritative usage and common understanding of the meaning of the word.

The economists on whose statements the Government has relied in other cases (*Lynch* v. *Turrish*, 247 U. S. 221, 227), do not give an authoritative usage and common understanding of the word "income." They attempt merely to express a certain philosophic analysis of economic, business and social values, conditions or relations in such words as they find possibly available. The conceptions which they attach to such a word as "income" in the special context in which they use it, must, for the purposes of the present discussion, be rejected, when they embrace gains not warranted by that authoritative usage and common understanding which is the criterion for the use of the word "income" in the Sixteenth Amendment.

Suppose property be exchanged by a legal and beneficial owner. Does the mere act of exchange cause an increase in capital assets to become income? Suppose instead of a primitive and direct exchange there is a sale for money as a convenient medium of exchange and the money is thereafter in due course used for a reinvestment already engaged for. Can it be said that the increase in capital assets which is ascertained in cash upon such a conversion at once becomes income?

A tax on the shifting of capital assets from one form to another is a direct tax on capital. A tax based upon any increase in the value of capital assets, appearing and definitely ascertained upon such shifting of capital assets from one form to another, is a direct tax on capital assets. It is not a tax on income within the Sixteenth Amendment.

C.

We submit that the authoritative decisions and declarations of this Court, both before and after the Sixteenth Amendment, forbid the conclusion that the mere act of converting capital assets into cash results in an increase in the value of capital assets, definitely ascertained thereby, becoming income.

1. We say that *Gray* v. *Darlington,* 15 Wall. 63, is an actual decision to the effect that a gain in the value of capital assets ascertained on conversion by a legal and beneficial owner, as a single isolated event, does not result in income as that term is used in the Sixteenth Amendment.

Our reasons for this are as follows:

First. In *Gray* v. *Darlington,* a profit of $20,000 was realized by the holder of bonds by a sale in 1869 of bonds purchased in 1865. It was held that the gain spread over the four years—two years before the Act of 1867 and two years after—was not taxable in any respect, nor to any extent, under the Act of 1867.

The plaintiff paid the tax assessed upon the whole increase and sued to recover it back. The Government demurred to the declaration. The demurrer was overruled and judgment was given against the Government for the entire amount of the tax. This judgment was affirmed. The taxpayer, therefore, recovered the *entire*

tax paid, so that the Government did not even receive a tax upon the increase which occurred in each year subsequent to the passage of the Act of 1867. If the Government had been entitled to any tax at all—as, for instance, upon the gain in the year in which the conversion occurred—the judgment must have been reversed. In order to affirm the judgment permitting the taxpayer to recover the *entire tax*, this Court was obliged to hold, and did hold, that under the Act of 1867 no increase at all in the value of capital assets, ascertained on conversion as a single isolated event, could be income.

Second. The Act of 1913 provided that net income should include "gains or profits and income derived from any source whatever." This clause, the court in *Eisner* v. *Macomber* held, indicated that Congress intended in the Act of 1913 to exert its power to the extent permitted by the Amendment; that, therefore, the Towne case in holding that a stock dividend was not income in the Act of 1913, in fact held that it was not income within the Sixteenth Amendment. When we turn to the Act of 1867 under which *Gray* v. *Darlington* was decided, we find that that Act, like the Act of 1913, provided that

> "In estimating gains, profits and income of any person, there shall be included all incomes derived * * * and all other gains, profits and income derived from any source whatever."

The Act of 1867 also provided for a tax upon the

> "gains, profits and income of every person * * * derived * * * from any source whatever."

Both clauses emphasize the fact that the Act of 1867 expressly went to the limit of the meaning of "gains, profits and income." If the Act of 1867, like the Act of 1913, used the word "income" in its most comprehensive sense, and in doing so, went as far as the Sixteenth

Amendment, then the decision in *Gray* v. *Darlington*, that the increase in the value of capital assets ascertained on conversion by a legal and beneficial owner as a single isolated event, could not give rise to income,—not even so far as the gain occurred in the year of conversion alone, or in the year preceding the year of conversion alone,—is decisive of the scope of the Constitutional Amendment.

Third. It will be said, however, that the opinion in *Gray* v. *Darlington* on its face, went upon a construction of the Act of 1867 which confined the gains which were taxable income, to *annual* gains, profits and income. That is true. Such was the general rule of the statute based upon the phrases "there shall be levied, collected and paid *annually* upon the gains, profits and income of every person," and "upon the gains, profits and income *for the year ending the thirty-first of December next preceding*," confirmed, perhaps, by the express exception as to gains from sales of real estate. The same general rule, however, must be the rule of the Act of 1913, for that Act, like the Act of 1867, provides that "there shall be levied, assessed, collected and paid *annually* upon the entire net income arising or accruing from all sources *in the preceding calendar year*." The general rule, however, of the Act of 1867, which must also be the general rule as to the Act of 1913, regarding the necessity of "annual gains, profits and income," would not in the least exclude the assessment of a tax on a gain in capital assets spread over several years, when ascertained by conversion, for, if this produced an income, it would be an *income arising in the year of conversion*, just as the dividends involved in *Lynch* v. *Hornby*, 247 U. S. 339, and *Peabody* v. *Eisner*, 247 U. S. 347, were dividends in the year in which they were declared, although they were paid out of surplus accumulated prior to

March 1, 1913. It follows, therefore, that the fact that the Act of 1867 was construed to apply to annual gains, would not in the least exclude a gain due to an increase in the value of capital assets ascertained upon conversion, if it were income.

The court, however, in *Gray* v. *Darlington*, having settled the scope of the Act in general as including *annual* gains, profits and income, went on to consider the exceptions which must be made in view of that clause of the Act which provided that the income taxed should include "all other gains, profits and income derived from any source whatever." Such a clause—as the court held in regard to the Act of 1913—went to the limit of the meaning of "income" and was as broad as the meaning of income in the Sixteenth Amendment. In the same way, it went to the limit of the meaning of "income" when employed in the Act of 1867. Yet when the court comes to determine the scope of such a clause, what does it do? It only lets in gains spread over a number of years due to increases in capital assets, *when the capital assets are being turned over for profit in the course of buying and selling in* "TRADE AND COMMERCE." It declines to give the words any effect when a gain in the value of capital assets, ascertained on conversion as a single isolated event, is involved, and in so refusing, it states as the express ground for the decision, the conclusion that the increase in the value of the capital assets is not income at all, but capital. The Court said:

> "The mere fact that property has advanced in value between the date of its acquisition *and sale* does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits or income specified by the statute. It constitutes and can be treated merely as increase of capital."

The conclusion is irresistible that *Gray* v. *Darlington*

in determining the effect of language even broader than that of the Constitutional Amendment, drew a line which excluded as income, gains to capital assets ascertained on conversion as a single isolated event by a legal and beneficial owner.

Fourth. In *Hays* v. *Gauley Mountain Coal Co.* 247 U. S. 189, the court in stating the point of *Gray* v. *Darlington*, said that it held that

> "by the true construction of the act, except as to gains and profits from trade and commerce and sales of real property, the statute only applied to such gains, profits and income as were strictly acquisitions made *during the year preceding that in which the assessment was levied* and collected."

If this suggests that the Act of 1867 did not apply because the gain in question was spread over four years instead of the purchase and sale occurring in a single year, then justice is not done to *Gray* v. *Darlington*. The court in *Gray* v. *Darlington*, after stating that

> "the assessment, collection, and payment prescribed are to be made upon the annual products or income of one's property or labor, or such gains or profits as may be realized from a business transaction begun and completed during the preceding year,"

went on to consider the scope of the exceptions deduced from the language of the Act of 1867, which provided that

> "in estimating gains, profits and income of any person, there shall be included all incomes derived * * * and *all other gains, profits and income derived from any source whatever.*"

Under this all-embracing provision the court let in the profits arising from sales in the course of "trade and commence," although the transactions involved did not begin and end within the year. There was no reason why it should not also include the gains from sales as isolated transactions, if such sales produced "income." This

was apparent to the court. It, therefore, refused to hold that the broad language of the Act of 1867 last quoted included gains ascertained by conversion as an isolated event, for the sole and only reason that such gains were not income, but remained capital.

2. After *Gray* v. *Darlington, supra,* came the Sixteenth Amendment. It uses, not the words of the Act of 1867, "gains, profits and income from whatever source derived," but merely the one word "incomes," and added "from whatever source derived." The omission is significant. Those who voted for the Sixteenth Amendment excluded *gains* and *profits* as such and granted to Congress a power to tax only "income." With the words "gains and profits" omitted the Constitutional Amendment was in precisely the same form as the phrase of the Act of 1867 "income derived from any source whatever." It is difficult to close one's eyes to the fact that the language of the Amendment was selected in the light of the decision of this Court in *Gray* v. *Darlington.* In order that there might be no basis for enlarging the scope of the Amendment, the words "gains and profits" were particularly omitted. The decision in *Gray* v. *Darlington* became, therefore, as much a part of the Amendment as did the language used in it.

It is material to remind the court that whether an increase in the value of stock ascertained upon conversion, is to be paid to a life tenant or retained for the remaindermen, has been made to turn on whether "income" alone has been left to the life tenant, or whether the life tenant was to have not only the "income" but also "gains and profits." (*Ante,* pp. 29-38.)

The existence of *Gray* v. *Darlington* as well as the cases involving the rights of life tenants and remaindermen, at the time the Sixteenth Amendment was adopted is a material fact to urge, particularly

upon the two justices whose views are contained in the opinion of Mr. Justice Holmes appearing in the second stock dividend case. If "the word 'incomes' in the Sixteenth Amendment should be read 'in a sense most obvious to the common understanding at the time of its adoption,'" then it may fairly be asserted that the mere increase in the value of a capital asset, ascertained by conversion as a single isolated event, cannot be regarded as income within the Amendment. It may fairly be said also that when the Sixteenth Amendment was adopted no question existed as to whether the mere increase in the value of capital assets, ascertained by conversion as a single isolated event, was income or not. It had been settled in *Gray* v. *Darlington* that it was not income from any source whatever. It follows that it cannot be said that "most people not lawyers," when they voted for the Amendment supposed that they had put "a question like the present to rest." There wasn't any question at all to put to rest. *Gray* v. *Darlington* had settled the point. The decision of this Court it is fair to assume, in construing the language of the Act of 1867, "gains, profits and income from any source whatever," did so in accordance with the "common understanding" and this common understanding continued, so far as appears, until the time of the adoption of the Sixteenth Amendment.

3. In *Lynch* v. *Turrish*, 247 U. S. 221, this Court held that a gain in the value of the capital assets of a corporation, which actually occurred before March 1, 1913, but which was ascertained subsequently by the conversion of the corporate assets, as a single isolated event, on winding up, was not "income" within the Act of 1913. This case in fact followed *Gray* v. *Darlington* in an actual holding that the gain so realized by conversion could not,

even if it occurred after March 1, 1913, be income within the Sixteenth Amendment. It was, therefore, a decision to the same effect as *Gray* v. *Darlington*, but having reference to the Amendment which had already been adopted. The correctness of this statement is supported by the following considerations:

First. The Act of 1913, under which *Lynch* v. *Turrish* was decided, provided that the net income of a taxable person shall include "gains or profits and income derived from any source whatever." This Court, in the second stock dividend case (*Eisner* v. *Macomber*, *supra*), held that these words were intended to, and did in fact, go to the limit of the constitutional power granted by the Amendment. Hence, if the conversion in the Turrish case could result in income within the meaning of the Constitution, it was income within the meaning of the statute. If this Court held that the gain realized on the conversion was not income within the statute, it also held that it was not income within the Sixteenth Amendment.

Second. The fact that the gain occurred prior to March 1, 1913, was of no significance whatever. The Act of 1913, as already demonstrated, went to the limit of the constitutional power of Congress in taxing incomes. It cannot be said that a gain in the value of capital assets which is not income before conversion but is income on conversion, is not within the power of Congress to tax as income at the time of conversion, when it becomes income. *Lynch* v. *Hornby*, 247 U. S. 339, and *Peabody* v. *Eisner*, 247 U. S. 347, demonstrate this. Those cases held that the dividend of a corporation, declared out of earnings accumulated prior to March 1, 1913, was, nevertheless, taxable as income at the date of payment. So, in *Eisner* v. *Macomber*, it was held that if a stock dividend were income, it would be

income for the year in which it was declared and distributed, even though it represented exclusively surplus of the corporation accumulated prior to March 1, 1913.* It follows that if the gain in the value of capital assets ascertained on conversion is income, the Act of 1913, which, as this Court held in *Eisner* v. *Macomber*, went to the limit of the power of Congress to tax income, did in fact attempt to tax as income such a gain in capital assets, and to so tax it as income in the year of conversion, regardless of when the gain itself may have occurred. *Lynch* v. *Hornby, Peabody* v. *Eisner* and *Eisner* v. *Macomber* demonstrate the soundness of this proposition also. Surely if a gain in the value of capital assets becomes income on conversion, the act of conversion is in all respects the same as the act of declaring a dividend by a corporation. If the Act of 1913 taxes as income, dividends, and even extraordinary dividends, paid out of surplus earnings accumulated prior to March 1, 1913, can it be said that the Act did not—in going the limit of the power of Congress—attempt to tax an increase in the value of capital assets ascertained on conversion as income at the time of conversion? In *Eisner* v. *Macomber* this Court even held that if a stock dividend were income, the fact that it was paid out of surplus accumulated prior to March 1, 1913, would not prevent its being taxable as income at the date of the distribution of the stock dividend. How, then, can it be said that the Act

*It should be noticed that the rule of *Doyle* v. *Mitchell Bros.* 247 U. S. 179, and *Hays* v. *Gauley Mountain Coal Co.* 247 U. S. 189, does not in any way contradict the position taken in the *Hornby*, Peabody and Macomber cases, *supra*. The Doyle and Hays cases dealt with the construction of the Corporation Excise Tax of 1909, so that no question arose in them which turned on the power of Congress to tax incomes as distinguished from capital. This court, upon the construction of the Corporation Excise Act of 1909, held that the excise tax was to be levied upon the doing of business in a corporate capacity which included gains ascertained on conversion arising from corporate activities but only those gains were to be taxed which arose since the act went into effect in 1909. *Post*, pp. 73-75.

of 1913 did not attempt to tax as income at the date of conversion a gain in the value of capital assets ascertained by conversion (if the same was income at all), regardless of when the gain in the value of capital assets occurred? We submit that if an increase in the value of capital assets ascertained on conversion is income, then under *Lynch* v. *Hornby, Peabody* v. *Eisner* and *Eisner* v. *Macomber*, it is income as of the date of conversion and that the Act of 1913 attempted to tax it as income at the time of conversion. When, therefore, the court in *Lynch* v. *Turrish* held it was not so taxable, it rendered a decision that it was not income *on the date of conversion* and hence was *not income within the Constitutional Amendment*. Such a holding is a decision, actual and complete, that a gain in the value of capital assets of a legal and beneficial owner, ascertained by conversion as a single isolated event, does not result in income within the Amendment.

Third. The true line of distinction between the Hornby case and the Turrish case is that in the former the Court was dealing with a dividend declared which was in fact income when declared and paid; while in the Turrish case the Court was dealing with a gain in capital assets ascertained by conversion as a single isolated event, which if income at all, would have been income at the time of conversion, just like a dividend declared and paid, but which was not income at all, but capital simply changed from one form to another.

Fourth. It is apparent from the opinion of the Court in the Turrish case that it felt the necessity of going the full length of *Gray* v. *Darlington* in order to support its decision. It relied upon *Gray* v. *Darlington*. It quoted with approval the following passage from *Gray* v. *Darlington:*

" 'The mere fact that property has advanced in

value between the date of its acquisition and sale does not authorize the imposition of the tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital.' "

This Court then stated:

"This case has not been since questioned or modified."

Later on this Court in the Turrish case recognized that *Gray* v. *Darlington* not only decides

"that the gradual advance in the value of property during a series of years in no just sense can be ascribed to a particular year, not therefore as 'arising or accruing,' to meet the challenge of the words, in the last one of the years, as the government contends, and taxable as income for that year or when turned into cash,"

but also that it

"decides that such advance in value is not income at all, but merely increase of capital, and not subject to a tax as income."

Earlier in the opinion the court makes the following statement which indicates the extent to which it relied upon the former precedent of *Gray* v. *Darlington:*

"The government's resource is the discussion of economists and the fact, concrete and practical, of wealth *not only increased, but come to actual hand.* The instant case is an example. Turrish's stock doubled in value. He paid for it $79,975; he received $159,950. It requires a struggle to resist the influence of the fact, *but we are aided and fortified by our own precedents* and saved from much intricate and subtle discussion and an elaborate review of other cases cited in confirmation or opposition."

D.

Under the British Income Tax Act (16 & 17 Vict. c. 34) it is established that appreciations in value of capital assets, *even after the realization of profits by sale*, do not constitute taxable income except in cases of transactions by dealers or other persons who buy and sell for purposes of profit.

Tebrau (Johore) Rubber Syndicate, Limited, v. *Farmer, S. T.* 5 Income Tax Cases, 658.

The Hudson's Bay Company v. *Stevens*, 5 Income Tax Cases, 424.

The Assets Company, Ltd. v. *The Inland Revenue*, Cases in the Court of Session, 4th Series, Vol. 24, p. 578.

These cases at least indicate that during a long period of years in England it was neither impracticable nor in violation of the usual and natural conception of income to draw a line between gains in capital assets which are ascertained upon conversion as a single isolated event, and gains which are the result of carrying on a business of buying and selling capital assets for the purpose of producing a profit—the latter being taxable as income and the former not.

The English Act (16 & 17 Vict. c. 34, sec. 2, Schedule D) used the phrase "annual profits or gains arising or accruing to any person." It did not use the word "income." The Act was, therefore, on the basis of the words "profits and gains" (omitting "income"), broader than the Constitutional Amendment. The Act of 1867 uses the phrases: "There shall be levied, collected and paid *annually* upon the gains, profits and income of every person," and the tax shall be "assessed, collected and paid upon the gains or profits and income *for the year ending the thirty-first of December next preceding* the

time of levying, collecting and paying said tax." These expressions the court held in *Gray* v. *Darlington* caused the act to refer to "annual gains, profits and income," so that the Act of 1867, except for the addition of the word "income," read like the English Act. In the same way, the Act of 1913 read (par. A, subdiv. 1) that "there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources *in the preceding calendar year.*" In par. B it is provided that "the net income of a taxable person shall include *gains, profits* and *income* derived," etc. These words must, under *Gray* v. *Darlington,* be taken as a designation of *annual gains, profits and income.* The Act of 1913, therefore, also reads in substance like the English Act.

In *Eisner* v. *Macomber* this Court held that the Act of 1913 went to the limit of the constitutional power of Congress under the Amendment and this was equally a holding that the Act of 1867 went to the limit of the meaning of the word "income." It, therefore, is a fair inference that the language of the English Act, although using "profits or gains," and not the word "income," but referring to "*annual* profits or gains," and being in that respect in substance the same as the Acts of 1913 and 1867, had the same scope as the Sixteenth Amendment. The decisions, therefore, under the English Act, rendered before the Sixteenth Amendment, are material and important, if not, indeed, conclusive, in fixing the scope of the Amendment.

The distinction made in the English cases was approved in *Gray* v. *Darlington.* There the court, under a statute which taxed "gains, profits and income derived from any source whatever," started with the general proposition

"that the assessment, collection, and payment pre-

> scribed are to be made upon the *annual* products or income of one's property or labor, or such gains or profits as may be realized from a business transaction *begun and completed during the preceding year.*"

To this the court said there were certain exceptions. One was expressed in the statute and related to "profits upon sales of real property, requiring, in the estimate of gains, the profits of such sales to be included where the property has been purchased, not only within the preceding year, but within the two previous years," and the other embraced "gains and profits from trade and commerce." As to the latter the court said:

> "Another exception is implied from the provision of the statute which requires all gains, profits and income derived from any source whatever, in addition to the sources enumerated, to be included in the estimation of the assessor. The estimation must, therefore, necessarily embrace *gains and profits from trade and commerce,* and these, for their successful prosecution, often require property to be held over a year. In the estimation of gains of any one year, the trader and merchant will, in consequence, often be compelled to include the amount recieved upon goods sold over their cost, which were purchased in a previous year. Indeed, in the estimation of the gains and profits of a trading or commercial business for any one year, the result of many transactions have generally to be taken into account which originated previously."

There the court stops. It not only does not admit another exception, which would include an increase in the value of capital assets ascertained on conversion as a single isolated event, but it definitely excludes such an increase because it is not income, but capital.

E.

The moment this Court seeks to break down the distinction between gains derived from a conversion of capital assets as a single isolated event and gains derived from conversions in the course of carrying on a business of buying and selling capital assets and to hold that gains in the former case are income as well as in the latter, it is face to face with a dilemma.

If the increase in the value of capital assets ascertained on conversion as a single isolated event is not income prior to the conversion, but becomes income only upon the conversion, then it must either be income in the year when the conversion occurs and taxable as the income of that year no matter how long the increase in value has been accruing, or it must be income in each year in which the increase occurs and taxable as income only in each year that it occurred under the act in force in that year.

If the court takes the first horn of the dilemma, then it permits a tax, not on the gain in each year, which, while it is not income, is the basis of the alleged income, but upon the act of conversion by which all the gains for many years come to hand. The increase in the value of the capital assets may be spread over a hundred years, as the Court said in *Gray* v. *Darlington*. The height of the increase may have been reached many years before conversion, as this Court also stated in *Gray* v. *Darlington*. The increase in value may have fluctuated over a period of years. It may have been high when the capital asset was purchased in 1912, and low on March 1, 1913. It may then have been converted in 1917 at a price very much higher than the value on March 1, 1913, but still lower than the capital asset was purchased for in 1912, thus showing a great gain over

the value on March 1, 1913, but a net loss over the purchase price. Such a case we understand is now on its way to this Court. Such cases will present absurdity and incongruity of result if this court supports the tax as a tax on the act of conversion, or the proceeds of conversion, as a unit of income, and ignores the fact that it is the gain (declared, however, to be capital) which is really the object of the tax.

If this Court takes the second horn of the dilemma it must perform some extraordinary mental gymnastics. While in one breath it says that a mere increase in the value of capital assets is not income at all, it must proclaim that on conversion the increase, which was not income at all, became income for the year in which the increase accrued when it was capital and not income. The Court must then say that after the year in which the increase occurred, the increase is permanently added to capital and can never be income for any other year. Yet it never became income at all till a conversion, which is a mere change of capital from one form to another. Furthermore, the gain is not permitted to be income at the time of conversion, which is the condition to its becoming income at all.

We submit that *Gray* v. *Darlington* and *Lynch* v. *Turrish* show that this Court, rather than face the dilemma and difficulties above set out, has definitely and authoritatively determined and decided to heed the rational line between capital and income which the English cases have adopted and to hold that the mere increase in the value of capital assets ascertained by conversion as a single isolated event, does not, even when the conversion is by a legal and beneficial owner, become income at all.

F.

There is nothing in the decisions or opinions of this Court denying full effect to *Gray* v. *Darlington* and *Lynch* v. *Turrish*.

The Doyle and Hays cases (*Doyle* v. *Mitchell Bros. Co.* 247 U. S. 179; *Hays* v. *Gauley Mountain Coal Co.* 247 U. S. 189) do not announce any rule or opinion that the mere increase in the value of the capital assets of every legal and beneficial owner, ascertained on conversion as a single isolated event, results in the production of income. Both cases alike arose under the Corporation Excise Tax Act of 1909, which was not an income tax law at all, but an excise tax act, taxing the conduct of business by a corporation in its corporate activity. As was said by this Court in *Anderson* v. *Forty-two Broadway Co.* 239 U. S. 69, 72:

> "The act of 1909 was *not in any proper sense an income tax law, nor intended as such*, but was an excise upon the conduct of business in a corporate capacity, the tax being measured by reference to the income in a manner prescribed by the act itself."

Again, in the Doyle case itself the court said the tax was imposed

> " 'not upon the franchises of the corporation irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate or insurance business and with respect to the carrying on thereof,' an exposition that has been consistently adhered to."

In sustaining and construing the Corporation Excise Tax Act of 1909 no question, therefore, arose involving a power of Congress which depended upon whether the tax was upon *income* or *capital*. Congress was free to tax the conduct of the business of the corporation and to base the tax on "the gainful returns from their business operations and property," whether such gainful re-

turns were strictly income or included something more than merely income. This Court in the Doyle case held that upon the proper construction of the Act such was its purpose and its express effect. After summarizing many pertinent provisions of the Act, the Court said (p. 183):

> "An examination of these and other provisions of the act makes it plain that the legislative purpose was not to tax property as such, or the mere conversion of property, but to tax *the conduct of the business of corporations organized for profit by a measure based upon the gainful returns from their business operations and property* from the time the act took effect. * * * The suggestion that the entire proceeds of the conversion should be still treated as the same capital, changed only in form and containing no element of income, although including an increment of value, we reject at once as inconsistent with *the general purpose of the act.* Selling for profit is too familiar *a business transaction* to permit us to suppose that it was intended to be omitted from consideration in an act for *taxing the doing of business in corporate form* upon the basis of the income received 'from all sources.' * * * (p. 185.) Whatever difficulty there may be about a precise and scientific definition of 'income,' it imports, as used here [in the Corporation Excise Tax Act]), something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; *conveying rather the idea of gain or increase arising from corporate activities.*"

In the Hays case the court again referred to the various provisions of the Act of 1909, upon which its conclusion rested, and said:

> "As we have shown in *Doyle* v. *Mitchell Bros. Co., ante,* 179, since a conversion of capital often results in gain, the general purpose of the Act of 1909 to measure the tax by *the increase arising from corporate activities,* together *with the income from invested property,* leads to the inference that that portion of the gross proceeds which represents gain

> or increase acquired after the taking effect of the act must be regarded as 'gross income.'"

Here the court very obviously distinguishes between the tax calculated, according to the statute, upon "the increase arising from corporate activities," which may include increases in the value of the capital assets of the corporation arising from corporate activities and ascertained upon conversion, and "the income from invested property." The tax under the Act of 1909 is calculated on the basis of gains of both sorts.

It cannot, therefore, be said that either the Doyle or the Hays cases turn on the question of what is "income" as that term alone is used in the Sixteenth Amendment. On the contrary, those cases only held that upon the proper construction of the provisions of a Corporation Excise Tax Act the excise tax was based upon gains which included more than merely "income."

In the stock dividend case (*Eisner* v. *Macomber*, 252 U. S. 189) there are two passages which might seem to commit the court to the view that any increase in the value of capital assets ascertained in cash by conversion is *per se* income under all circumstances. On p. 207 the court said:

> "'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include *profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case.*"

This careful statement means what it says—that when there is a conversion of capital assets *such as occurred in the Doyle case*, income may result. The gain ascertained by the conversion of capital assets in the Doyle case was a gain arising from the regular turnover of the corporate capital, or part of it, in the ordinary course of its corporate activities. In other words, it was a gain

ascertained and realized from the carrying on of the business of buying and selling timber. When, therefore, this Court said that income must include "profit gained through a sale or conversion of capital assets, *to which it was applied in the Doyle Case,*" it merely means that income must be understood to include profit gained through a sale or conversion of capital assets in the regular course of corporate or individual business activities in buying and selling.

In the stock dividend case (*Eisner* v. *Macomber*, 252 U. S. 189, 212) this Court said, speaking of the sale by a stockholder of the new shares acquired in a stock dividend:

> "It is equally true that if he does sell, and in doing so realizes a profit, such profit, like any other, is income, and so far as it may have arisen since the Sixteenth Amendment is taxable by Congress without apportionment. The same would be true were he to sell some of his original shares at a profit."

Taken in connection with the decisions and other statements of this Court, the above language must not be taken to mean that every increase in the value of capital assets ascertained by conversion is *per se* income, but only that such increase in the value of capital assets realized by conversion is income where conversion occurs and the profit is taken in the business of buying and selling capital assets for profit.

Part 2.

The Act of 1916-17 By Its Proper Construction Does Not Permit the Assessment of Any Tax at All Upon the Increase in Value of the Capital Assets in Question.

I.

EXPLICIT LANGUAGE BY CONGRESS IS REQUIRED BEFORE THIS COURT WILL SO CONSTRUE THE ACT THAT IT WILL OPERATE TO TAX AS INCOME FOR THE YEAR OF CONVERSION THE TOTAL INCREASE IN THE VALUE OF CAPITAL ASSETS OCCURRING OVER AN EXTENDED SERIES OF YEARS.

This Court in *Gray* v. *Darlington, supra,* under an Act which taxed "gains, profits and income derived from any source whatever," held that an increase in the value of capital assets, extending over a series of years, ascertained on conversion as a single isolated event by a legal and beneficial owner, was not income for any year; that not even the gain which occurred in the year of the conversion, when the Act of 1867 was in force, was taxable as income for that year. So, in *Lynch* v. *Turrish, supra,* this Court held that under the Act of 1913 an increase in the value of capital assets occurring before the Act of 1913, but realized by conversion after that Act was in force, was not taxable income under the Act—although that Act also provided that taxable income should include "gains or profits and income derived from any source whatever." So, in *Towne* v. *Eisner,* 245 U. S. 418, this Court held that under the same phrase in the Act of 1913 a stock dividend, even assuming that it was income within the Constitutional Amendment, would not be included. These cases, therefore, show a determination on the part of this Court, *whenever there is in-*

volved the question of the taxability as income of an increase in the value of capital assets which may be spread over a considerable number of years, to require the most explicit language of the statute before such increase so extending over a number of years, shall be taxable as the income of one year, *namely,* the year of conversion. The reasons for this are obvious. To include in the definition of income an increase in the value of capital assets when ascertained on conversion as an isolated event, is to place a very extraordinary meaning upon the word "income." The results are harsh and discriminatory, for the increase in the value of capital assets of one taxpayer may have been spread over many years, while that of another may have occurred entirely within the year. As this Court said in *Gray* v. *Darlington,* 15 Wall. 63, 66:

> "The rule adopted by the officers of the revenue in the present case would justify them in treating as gains of one year the increase in the value of property extending through any number of years, through even the entire century. The actual advance in value of property over its cost may, in fact, reach its height years before its sale; the value of the property may, in truth, be less at the time of the sale than at any previous period in ten years, yet, if the amount received exceed the actual cost of the property, the excess is to be treated, according to their views, as gains of the owner for the year in which the sale takes place. *We are satisfied that no such result was intended by the statute.*"

The above cases at once challenge the Government to show a clear and explicit provision of the Act of 1916-17 assessing the income tax upon all or any part of the gain in value of a capital asset occurring during a series of years and ascertained by conversion in the year in which the tax is assessed, as the income wholly of the year of conversion. The above cases particularly chal-

lenge the Government to produce a clear and explicit provision of the Act of 1916-17 which requires such a tax to be assessed against a trustee for life tenant and remaindermen, when the gain so ascertained by conversion has not come into the hands of anyone for his separate use, benefit and disposal and may never do so, or, if it does, may come into the hands of so many that only the normal tax would be collectible from each.

Such a challenge, we submit, the Government entirely fails to meet.

II.

GRAY V. DARLINGTON AND LYNCH V. TURRISH ARE DECISIVE THAT THE ACT OF 1916-17 DOES NOT APPLY TO ANY INCREASE IN THE VALUE OF CAPITAL ASSETS ASCERTAINED BY CONVERSION AS A SINGLE ISOLATED EVENT.

A.

The Act of 1867 involved in *Gray* v. *Darlington* provided:

> "There shall be levied, collected, and paid *annually* upon the gains, profits, and income of every person, * * *. And the tax herein provided for shall be assessed, collected, and paid upon the gains, profits, and income *for the year ending the 31st of December next preceding* the time for levying, collecting, and paying said tax.
>
> "In estimating the gains, profits, and income of any person, there shall be included all incomes derived from interest * * * and all other gains, profits, and income derived from any source whatever."

The opinion of the court is based not at all on the words "derived" or "for." So far as these words are concerned they might as well be "arising or accruing," or "received for." The court did go upon the use of

the word "annually" and the words "for the year ending the 31st of December next preceding." Both expressions are italicized in the Statement of Facts in the report of the case. That the court went solely on those words is clear from its opinion. The Court said:

> "The advance in the value of property during a series of years can, in no just sense, be considered the gains, profits, or income of any one particular year of the series, although the entire amount of the advance be at one time turned into money by a sale of the property. The statute looks, with some exceptions, for subjects of taxation only to *annual* gains, profits, and income. Its general language is 'that there shall be levied, collected, and paid *annually* upon the gains, profits, and income of every person,' derived from certain specified sources, a tax of five per cent, and that this tax shall be 'assessed, collected, and paid upon the gains, profits, and income for the *year ending the 31st of December next preceding* the time for levying, collecting, and paying said tax.'"

The British Income Tax Act (16 & 17 Vict., c. 34, sec. 2, schedule D) uses the phrase "the annual profits or gains arising or accruing to any person." The use of the word "annual" in the British Act has the same meaning and effect as the reference in the Act of 1867 to the "gains, profits, and income for the year ending the 31st of December next preceding." Under the English Act the same distinction was made as that approved in *Gray v. Darlington, namely*, that the gains represented by an increase in the value of capital assets, ascertained on conversion as a single isolated event, are not taxable. Only gains in the value of capital assets realized in the course of the business of buying and selling were within the Act. (*Ante*, pp. 68-70.)

The Act of 1913 had the same features substantially as the Act of 1867. It provided (par. A, subdiv. 1):

> "That there shall be levied, assessed, collected and

paid *annually* upon the entire net income arising or accruing from all sources in the preceding calendar year * * *."

In par. D it was provided:

"The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first; *Provided, however*, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income *accruing* from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive * * *."

This Court in the Turrish case (*Lynch* v. *Turrish*, 247 U. S. 221), adopted the same view of this language that the court in *Gray* v. *Darlington* did of the language of the Act of 1867. It held that the Act of 1913 did not tax any increase in the value of capital assets which occurred prior to the time when the act took effect, even though such increase was realized by conversion and came to the hand of the taxpayer after the act took effect. Again, the court rested its opinion upon the words "in the preceding calendar year" and "that for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen." It was this language which, like the similar words in the Act of 1867, led irresistibly to the conclusion that an increase in the value of capital assets going on over a series of years and then realized and coming to hand in a single year by conversion, was not taxable within the terms of the statute.

No special significance was attached to the words "arising or accruing." They might have been "derived," or "for," or "received in," and the result would have been the same. Indeed, the Government attempted to make the case turn on a difference between the word

"derived" as used in the Act of 1867 and the words "arising or accruing" in the Act of 1913. In reply to this the Court said (p. 230):

> "The Government, however, makes its view depend upon disputable differences between certain words of the two acts. It urges that the Act of 1913 makes the income taxed one 'arising or accruing' in the preceding calendar year, while the Act of 1867 makes the income one 'derived.' Granting that there is a shade of difference between the words, it cannot be granted that Congress made that shade a criterion of intention and committed the construction of its legislation to the disputes of purists."

This signifies to us that the court was of opinion that even if the word "received" had been used the result would not have been different, because the court's decision in the Turrish case was not based upon whether the words "derived," or "arising or accruing," or "received," were used, or any other words of like significance in their place, but upon the words "annually" and "in the preceding year" and "net income accruing from March first, nineteen hundred and thirteen."

We are fortified in this conclusion by finding that this Court, in the second stock dividend case (*Eisner* v. *Macomber*), used "derived" and "received" as entirely interchangeable when they are used as the verb with "income." The Court in defining "income" as something of exchangeable value, added the following qualification: "coming in, being '*derived,*' that is, *received* or drawn by the recipient." When this Court itself thus recognizes the interchangeable meaning of "derived" and "received," when those words are used as the verb for "income," it is difficult to believe that this Court in construing two Income Tax Statutes in all respects alike, except that one used the word "derived" as the verb for "income" and the other used the word "received" as the verb for "income," would obtain two dif-

ferent results with respect to what was taxable, depending entirely upon the use of the different expressions.

The moment the court concludes from the use of the words "annually" and "in the preceding calendar year," or any other context or absence of context, that an increase in the value of capital assets spread over a number of years and ascertained by conversion, as a single isolated event, is not included in the statute as income, it makes no difference whether the word "received" or "arising or accruing" is used. The former expression has no more force than the latter to include in the act such mere increases in the value of capital assets.

B.

Section 1 of the Act of 1916-17 contains (with one exception) the same expressions as par. A of the Act of 1913 and is substantially the same as the language of the Act of 1867 involved in *Gray* v. *Darlington*. Section 1 of the Act of 1916-17 provides:

> "That there shall be levied, assessed, collected, and paid *annually* upon the entire net income received *in the preceding calendar year* from all sources."

The only difference between this and par. A of the Act of 1913 is the use of the word "received" in place of the words "arising or accruing." In the Act of 1867 the word was "derived," or "derived for," or "for." As, however, we have already observed, *Gray* v. *Darlington* and *Lynch* v. *Turrish* did not go upon the use of these different phrases, but upon the use of the word "annually" and "for the preceding calendar year," or "for the year ending the thirty-first of December next preceding," and these expressions appear in precisely the same context in the Act of 1916-17. Hence the immaterial or insignificant change consisting of inserting the word

"received" in the Act of 1916-17, can make no difference. As this Court said in the Turrish case, speaking of the difference claimed by the Government between the word "derived," or "arising or accruing":

> "Granting that there is a shade of difference between the words, it cannot be granted that Congress made that shade a criterion of intention and committed the construction of its legislation to the disputes of purists."

In *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, this Court pointed out that the Act of 1913, Sec. G, paragraph (a)

> "provides that the tax shall be levied upon the entire '*net income arising or accruing* from all sources during the preceding calendar year.' But in paragraph (b), providing for deductions, gross income is described as that 'received within the year from all sources.' So that, with respect to domestic corporations, it is clear enough that no change was intended by the use of the expression 'arising or accruing,' in the Income Tax Act, and that the tax should be levied under both acts [the Corporation Excise Tax Act of 1909 and the Income Tax Act of 1913] upon the income 'received' during the year."

The consequence was that the Insurance Company was charged as income with amounts actually received by it and the amounts in question, which consisted of payments to agents not yet received by the treasurer of the company, were held to have been received by the company. Here, then, "arising or accruing" meant the same as "received"; but in the Act of 1867 "derived" meant the same as "received." So in the Act of 1913, Sec. A, "arising or accruing" meant the same as "received." This Court in the second stock dividend case (*Eisner* v. *Macomber*), in defining "income" used the word "derived" and "received" as interchangeable when used as the verb for "income." Hence, the words "received," "derived," or "arising or accruing," when used in the

same context in the Income Tax Acts, are quite interchangeable and the use of one of these expressions rather than another, can furnish no ground for saying that an increase in the value of capital assets ascertained on conversion as a single isolated event, was intended by an Income Tax Act to be assessed as income in the year of conversion, where the increase has been spread over a number of years.

There is no conflict between the view here presented of the interchangeability in an Income Tax Act of the words "derived," "arising or accruing," or "received," and the position taken by this Court in *Doyle* v. *Mitchell Brothers Co.* 247 U. S. 179, *Hays* v. *Gauley Mountain Coal Co. id.* 189, and *United States* v. *Cleveland, etc. Ry. Co. id.* 195, with regard to the gains, profits and income upon which the Corporation Excise Tax was assessable under the Corporation Excise Tax Act of 1909. The Court in the Doyle case, after a careful summary of many pertinent provisions of the Act of 1909, said (p. 183):

> "An examination of these and other provisions of the act makes it plain that the legislative purpose was not to tax property as such, or the mere conversion of property, but to tax *the conduct of the business of corporations organized for profit by a measure based upon the gainful returns from their business operations and property* from the time the act took effect. * * * The suggestion that the entire proceeds of the conversion should be still treated as the same capital, changed only in form and containing no element of income although including an increment of value, we reject at once as inconsistent with *the general purpose of the act.* Selling for profit is too familiar *a business transaction* to permit us to suppose that it was intended to be omitted from consideration in an act for *taxing the doing of business in corporate form* upon the basis of the income received 'from all sources.' * * * [p. 185.] Whatever difficulty there may be about a pre-

> cise and scientific definition of 'income,' it imports, as used here [in the Corporation Excise Tax Act], something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; *conveying rather the idea of gain or increase arising from corporate activities.*"

In the Hays case *Gray* v. *Darlington* was dealt with at length and distinguished. The Court said:

> "We do not regard the decision [in *Gray* v. *Darlington*] as controlling, *because the language of the act now under consideration is different in material particulars.* As pointed out in *Doyle* v. *Mitchell Brothers Co. ante*, 179, it imposes annually a special excise tax with respect to *the carrying on or doing business by the corporation* 'equivalent to one per centum upon the entire net income over and above five thousand dollars received by it from all sources during such year,' to be ascertained by taking gross income and applying certain exceptions and deductions."

Then the Court appears to make something of the difference between the word "for" in the Act of 1867 and the word "received" in the Corporation Excise Tax Act of 1909 and concluded:

> "There are other differences [between the Act of 1867 and the Act of 1909] upon which we need not dwell."

Plainly, therefore, the Hays case did not at all go on the mere difference between the word "derived" and the word "for" in the Act of 1867, and the word "received" in the Act of 1909, but upon many other vital differences in the structure and character of the two Acts and principally on the ground that the Corporation Excise Tax Act levied a tax on "*the conduct of the business of corporations organized for profit*" and measured the tax with reference to "*the gainful returns from their business operations and property,*" or on the "*gain or increase arising from corporate activities,*" while the Income Tax Act is confined by the Constitution to a tax

upon "income," and by the proper construction of the Income Tax Act, it did not include increases in the value of capital assets ascertained by conversion as a single isolated event. So important and conclusive were the other provisions and general context of the Corporation Excise Tax Act in justifying the decision of the court that we venture the assertion that had the Corporation Excise Tax Act used the word "derived" or the word "for," or the phrase "arising or accruing" in place of the word "received," the result would have been the same.

The Government may argue that Sec. 2 (c) of the Act of 1916-17 indicates that an increase in the value of capital assets is to be taxed during the year of conversion, although that increase may have extended over a period of time since 1913. As Sec. 2 (c) is an appendage to Sec. 2 (a) and must in its scope follow the construction to be given to "sales, or dealings in property" in Sec. 2 (a), the answer to the Government's contention, founded upon the presence of Sec. 2 (c), may best be made in considering whether Sec. 2 (a) and Sec. 2 (c) are effective to cause an increase in the value of capital assets ascertained upon sale, even by a legal and beneficial owner, to be taxable as income under the Act. That is the next matter for consideration.

III.

THE GAINS IN THE VALUE OF THE CAPITAL ASSETS OF A LEGAL AND BENEFICIAL OWNER, ASCERTAINED BY CONVERSION AS A SINGLE ISOLATED EVENT, ARE NOT TAXABLE AS INCOME UNDER SECTION 2 (a) OR (c) OF THE ACT OF 1916-17.

A.

The words "gains or profits and income derived from any source whatever" in Section 2 (a) are clearly insufficient to include the mere increase in the value of capital assets ascertained upon a conversion as a single isolated transaction. This statement is made under the authority of *Gray* v. *Darlington*, 15 Wall. 63, *Lynch* v. *Turrish, supra*, and the first stock dividend case (*Towne* v. *Eisner*, 245 U. S. 418).

B.

Is the increase in the value of capital assets ascertained upon a conversion as a single isolated transaction included as income in the Act by the words "gains, profits and income derived from * * * sales or dealings in property"? There are several reasons why it is not:

First. If "gains or profits and income derived from any source whatever" is insufficient to include an increase in the value of capital assets ascertained by conversion as a single isolated transaction, then the phrase "gains, profits and income derived from * * * sales or dealings in property" must equally be insufficient to do so. In both instances alike the transactions referred to are limited to those which produce "gains, profits and income." If this phrase, when coupled with the more general words "from any source whatever,"

does not include an increase in the value of capital assets ascertained upon a conversion as a single isolated transaction, then the same phrase, when coupled with the less inclusive words "sales or dealings in property" will be ineffective to do so.

Second. Following *Gray* v. *Darlington*, *supra*, the Turrish case, *supra*, and the Towne case (*Towne* v. *Eisner*, 245 U. S. 418), that extraordinary and unusual meanings of income are not included in the Act except by very explicit language, that clause of Sec. 2 (a) which reads "gains, profits and income derived from * * * sales or dealings in property" must be taken primarily as referring to gains and profits derived from the business of buying and selling capital assets. In this view the language of the Statute refers to the circumstances under which, according to the rule of the English cases already referred to, it was established that an increase in the value of capital assets ascertained on conversion became income when the gain was produced in the course of conducting the business of buying and selling, but not when the act of conversion was a single isolated event apart from any such dealing as in the Turrish case, *supra*, and *Gray* v. *Darlington*, *supra*. In *Gray* v. *Darlington*, 15 Wall. 63, under a statute which taxed "all gains, profits and income from whatever source derived," only such gains arising from the increased value of capital assets ascertained upon conversion were taxable as were realized in the course of "trade or commerce" in which the capital assets were turned over for profit. This Court in that case so distinctly stated. (See *ante*, p. 70.) If that be the correct view under the Income Tax Statute involved in *Gray* v. *Darlington*, *supra*, it is equally the correct view under the present Act so far as the

words "gains, profits and income derived from • • • sales or dealings in property" are concerned.

Third. The foregoing view is borne out by the sections of the Act of 1916-17 which deal with deductions for losses. It is persuasive that an act which requires gains from sales to be taxed as income and also allows losses occurring in sales to be deducted for the purpose of ascertaining a net income, was framed on the basis that such gains and losses should occur in the same sort of transaction. If, therefore, we find that losses can only be deducted when they occur from sales in the course of a business of buying and selling for profit, it is persuasive that gains from sales were only income when derived in the course of a business of buying and selling for profit.

The provisions in the Act of 1916-17 as to losses occur in Sec. 5, Subdivision "Fourth" and "Fifth." Subdivision "Fourth" by its terms refers to losses "in his [the taxpayer's] business or trade," and under this section losses sustained from the sale or other disposition of property must be losses occurring in sales in the course of a business or trade. So much is clear. Subdivision "Fifth" is as follows:

> "In transactions entered into for profit but not connected with his business or trade, the losses actually sustained therein during the year to an amount not exceeding the profits arising therefrom";

If any provision of the Act permits the taxpayer to include losses occurring in an isolated case of conversion of capital assets, it must be Subdivision "Fifth" above quoted. But no such construction can, it is believed, be placed upon that subdivision.

The use of the word "his" in the phrase "his business or trade" indicates that Subdivision "Fourth" of Sec. 5, which refers to losses "in his business or trade" refers

to the taxpayer's principal business or trade or principal businesses or trades and that Subdivision "Fifth" was to cover losses "in transactions entered into for profit" not in such principal trade or trades or business or businesses. That, however, is very far from an explicit statutory provision that in a single isolated case of conversion of capital assets the loss may be deducted.

The still more conclusive argument in support of the view that Subdivision "Fifth" does not permit the deduction of a loss in a single isolated conversion of capital assets is founded upon the words "not exceeding the profits arising therefrom." This makes it clear that no losses are allowed unless profits have been made in similar transactions. The losses can only be deducted when they occur "in transactions entered into for profit" where there are other transactions of the same nature also entered into for profit, in which a profit occurs. This is much more consistent with the view that losses must occur in the course of buying and selling for profit than that a loss occurring in a single isolated instance of conversion of capital assets may be deducted. Indeed, the language of Subdivision "Fifth" would seem to exclude the case of a loss in such a single isolated conversion of capital assets. Inferentially a gain from the same single isolated conversion of capital assets is also excluded.

Fourth. If the statute did cover gains in capital assets ascertained in dollars and cents on conversion, observe the incongruity of the result which would follow.

The gains in one case might be spread over many years, yet all would be received as income in a single year and a heavy tax laid upon them. In another case the same gain might be derived in one year, and yet the same tax only need be paid. Such an unequal and dis-

criminatory burden of taxation should not be imputed to Congress unless the most explicit language made such imputation necessary. As this Court said in *Gray* v. *Darlington*, "We are satisfied that no such result was intended by the statute."

If, to avoid the result just noted, this Court were to hold that the increase in the value of capital assets occurring in each year was income in the year in which it occurred, and was only subject to be taxed as such income in each year under the act in force in that year, but that no tax at all could be assessed until conversion, then it is obvious that the Act of 1916-17 is not constructed to meet any such theory. It makes no provision for the collection after conversion of additions to income occurring in preceding years under other acts, now repealed. It is not in the least devised to meet a situation where, at the time the increase in the value of capital assets becomes taxable, viz: in the year of conversion, it then must be taxed by a process of dividing the increase up among the years in which it occurred, and then assessing in the year of conversion a tax calculated on the basis of acts in force in preceding years.

Fifth. The Act of 1913 provided that "the net income of a taxable person shall include gains, profits and income derived from • • • sales or dealings in property." This is exactly the same language as that used in the Act of 1916-17 and an inference therefore arises that the words mean the same in the Act of 1916-17 as in the Act of 1913.

Gray v. *Darlington* held that the Income Tax Act of 1867 did not attempt to assess any tax on any increase in the value of capital assets occurring over a series of years, ascertained by conversion as a single isolated event. It did not

even attempt to assess a tax upon the grain which occurred in the year of conversion or in the year preceding the conversion, both of which years were after the Act of 1867 took effect. The Turrish case, while passing upon the effect of the Act of 1913 to assess a tax on an increase in the value of capital assets occurring wholly before the act took effect (though the conversion occurred afterwards), so far relied on *Gray* v. *Darlington* as to raise the inference that this Court would hold that under the Act of 1913 no increase in the value of capital assets occurring after 1913 and ascertained by conversion, would be taxable as income.

The Act of 1913 had the same features as were present in the Act of 1867 upon which the court, in *Gray* v. *Darlington*, held that an increase in the value of capital assets ascertained by conversion as a single isolated event, was not taxable. The Act of 1867 provided "that there shall be levied, collected and paid *annually* upon the gains, profits and income of every person," and that the tax should be "assessed, collected and paid upon the gains, profits and income *for the year ending the thirty-first of December next preceding*," and that income shall include "gains, profits and income derived from any source whatever." The court in reaching its conclusion relied upon the phrases above italicized. The Act of 1913 provided (par. A, subdiv. 1) "that there shall be levied, assessed, collected and paid *annually* upon the entire net income arising or accruing from all sources in the preceding calendar year," and par. B provided that "the net income of a taxable person shall include • • • gains, profits and income derived from any source whatever." If *Gray* v. *Darlington* held that such language as was used in the Act of 1867 permitted only the increase in the value of capital assets ascertained on conversion in the course of trade or commerce—that is, where there

was buying and selling of capital assets as a business—then the Act of 1913 must equally be confined to such conversions of capital assets and cannot be construed as authorizing the assessment of a tax upon a gain in capital assets ascertained on conversion as a single isolated event.

The Act of 1913 provided that losses from the sale of capital assets could only be deducted when they occurred "in trade" and this the Treasury Department construed to mean losses occurring in the course of the carrying on of a trade or business. (Treasury Dec. 2005, July 8, 1914.) If losses occurring only in the course of trade or business can be deducted, an inference arises that only gains or profits arising from sales or dealings in property carried on in the course of a trade or business can be counted as income. For this reason also in the Act of 1913 the words "gains, profits and income derived from • • • sales or dealings in property" cannot be regarded as including an increase in capital assets ascertained upon conversion as a single isolated transaction.

If that be the construction of the Act of 1913, then an inference arises that the same construction of precisely the same words in the Act of 1916-17, should be adopted.

C.

It will no doubt be argued that Section 2 (c) of the Act of 1916-17, which provides that

> "For the purpose of ascertaining the gain derived from the sale or other disposition of property, real, personal, or mixed, acquired before March first, nineteen hundred and thirteen, the fair market price or value of such property as of March first, nineteen hundred and thirteen, shall be the basis for determining the amount of such gain derived."

assumes that "sales, or dealings in property" as used in Sec. 2 (a) includes a sale or a dealing in property which is a mere conversion of capital assets as a single isolated event and that the legislative intent was, therefore, expressed in the Act of 1916-17 that an increase in the value of capital assets so ascertained by a single isolated conversion, was to be taxed as income.

There are several answers to this contention:

First. In the Act of 1913 no such clause appeared. Hence it is clear that the Act of 1913 never included as income an increase in the value of capital assets ascertained by conversion as a single isolated transaction as distinguished from conversions in the course of the business of buying and selling for profit. Hence, in the Act of 1913 "sales, or dealings in property" did not include such an increase in the value of capital assets as income. Hence the same words in the Act of 1916-17 would naturally mean the same and should not be given a different meaning by implication from Section 2 (c) providing for the taking of a value as of March 1st, 1913, if Section 2 (c) can have any other proper and reasonable explanation.

Second. Section 2 (c) in the Act of 1916-17 is entirely consistent with an interpretation of the Act which makes "sales, or dealings in property" in Section 2 (a) refer to sales or other dealings in property occurring in the course of a trade or business of buying and selling capital assets for profit.

It is clear that Section 2 (c) in referring to the "gain derived from the sale or other disposition of property" must refer to sales or other dealings in property occurring in the course of a trade or business, for Section 2 (c) applies with the greatest possible generality and without qualification and refers back precisely to the language of Section 2 (a) where "sales, or dealings in prop-

erty" are referred to with the same generality and without qualification and admittedly include sales or dealings in property occurring in the course of the business of buying and selling for profit. Furthermore, in the Act of 1918 the same clause, copied and enlarged, clearly refers to sales occurring in the course of a business of buying and selling. Section 202 (a) of the Act of 1918 provides

> "That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—
>
> • • • • •
>
> (2) In the case of property acquired on or after that date, [March 1st, 1913] the cost thereof; or the inventory value, if the inventory is made in accordance with section 203."

By reference to Section 203 regarding inventories, it there appears that the inventories referred to are such as shall conform "as nearly as may be to the best accounting practice in the trade or business." This makes it certain that in the Act of 1918 Section 202 refers to sales or other dispositions of property occurring in the course of carrying on a trade or business, and the inference equally arises that the corresponding section of the Act of 1916-17, which is Section 2 (c), also refers to the sale or other disposition of property occurring in the course of a business of buying and selling.

It is submitted that there is nothing which requires Section 2 (c) of the Act of 1916-17 to refer to any other sales or dispositions of property than those carried on in the course of a trade or business.

Third. If Sec. 2 (c) were permitted to apply to a conversion of capital assets as a single isolated transaction, one incongruous result, at least, would be obtained. Suppose A purchased stock in 1912 at 67. On March 1, 1913,

the stock was down to 20, but rose again and was sold in 1917 at 65. Here there would be a gain since March 1, 1913, but a loss upon the entire transaction. If A's sale as a single isolated conversion of capital assets is within Sec. 2 (a) and 2 (c), the result will be a large tax, when in fact an actual loss has occurred. Such a case, we understand, is on its way to this Court, if not already there.

IV.

THE ACT OF 1916-17 IN PARTICULAR CONTAINS NO PROVISION FOR THE TAXATION OF ANY INCREASE IN VALUE OF THE CAPITAL ASSETS OF A TRUST ESTATE HELD FOR LIFE TENANT AND REMAINDERMEN ASCERTAINED ON CONVERSION AS A SINGLE ISOLATED EVENT.

A.

The Income Tax Act makes a sharp distinction between the assessment of a tax against the income "received" by an *individual* for his own use and disposal, *i. e.*, by a "taxable person," and the income "received" by a *trustee* who has no use or disposal of the gain or income for himself, but holds it as a fiduciary for some one else. The trustee is not a "taxable person" in the sense of an individual who receives the income. The trustee is assessed (if at all) in lieu of the person who does so receive the income, either immediately or thereafter, and merely for the convenience of the Government in collecting the tax. Thus, Sec. 1 (a) of the Act of 1916-17 provides that the income taxed is the income "received" in the preceding calendar year "by every individual." In Sec. 2 (a) such an "individual" is referred to as a "taxable person" and the items included by the statute in the net income of such indi-

vidual or taxable person are defined. The Act thus makes it a fundamental requirement that before an income is taxed it must be received by some individual for his or her own use and disposal. This construction of the Act is fortified by the fact that in Sec. 2 (b) special provision is made for cases where a tax may be assessed against a trustee who is either obligated by the terms of the trust to pay the income over to some individual, or to hold and accumulate the income or postpone its payment until some future time. Thus it is provided in Sec. 2 (b) of the Act of 1916-17, that:

> "Income received by estates of deceased persons during the period of administration or settlement of the estate,"

shall be subject to tax, and also,

> "such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed."

These special provisions furnish a proper inference that Sec. 1 (a) and Sec. 2 (a), in referring to income "received" by an "INDIVIDUAL" or by a "TAXABLE PERSON," referred to persons who actually received the income for their use and disposal.

Clearly, the gain arising from an increase in value of the capital assets of the trust estate, held for life tenant and unascertained remaindermen, reduced to dollars and cents by conversion, as in the case at bar, has not been "derived by," or "arisen or accrued to," or been "received" by any individual for his use and disposal. It is not therefore, included in the language of Sec. 1 (a) or Section 2 (a).

The recent case of *First Trust & Savings Bank, Trustee under the Last Will of Otto Young, deceased,* v.

Smietanka (decided at the October term, 1920, in the Circuit Court of Appeals for the Seventh Circuit), supports the foregoing conclusion. The court there draws a clear distinction between the provisions of the Act of 1913, which provide for the taxing of incomes derived by *individuals* and received by them for their own use and disposal, and an income (in that case from the rental of real estate) derived by a trustee who is to hold it or accumulate it and pay it over at a future time to unascertained persons. The income so derived by the trustee was held to be not subject to a tax under the provisions of the Act of 1913.

Par. A of the Act of 1913 provided that there should be levied and collected annually a tax upon the entire net income accruing from all sources in the preceding calendar year

> "to every *citizen of the United States*, whether residing at home or abroad, and to *every person* residing in the United States, though not a citizen thereof, * * * and a like tax * * * upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by *persons* residing elsewhere."

Par. B provided:

> "Subject only to such exemptions and deductions as are hereinafter allowed, the net income of a *taxable person* shall include * * * income * * * growing out of * * * interest in real or personal property and income derived from any source whatever."

The reason why the above language was insufficient to warrant the levying of an income tax upon income from rents received by the trustee was because, as the Court of Appeals said, such rentals were not

> "a citizen or person or corporation, joint stock company or association, or insurance company, mutual or stock. In no calendar year preceding a levy was

there any sort of being to whom the trustee could pay or account for the accumulations of rentals."

In other words, a trustee, as such, was not a "taxable person" within the above quoted sections of the Act of 1913, as to income from rentals which it accumulated for the benefit of persons who could be ascertained only at a distant future time. Such income was only taxable, therefore, if it were expressly made so taxable under some other provisions of the Act relating to trustees and to the particular situation which was presented. Paragraph D was the only other section possible; but that only provided as follows:

> "Guardians, trustees, * * * and all persons, corporations or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals."

Obviously, the above section did not cover income received by a trustee to be accumulated and paid over at a distant future time to persons now unascertained.

Section 1 of the Act of 1916-17 provides:

> "That there shall be levied * * * annually upon the entire net income received in the preceding calendar year from all sources by *every individual*, a citizen or resident of the United States, a tax * * * and a like tax shall be levied * * * upon the entire net income received in the preceding calendar year from all sources within the United States by *every individual*, a nonresident alien, including interest on bonds, notes or other interest-bearing obligations of residents, corporate or otherwise."

Section 2 (a) is in the same form as paragraph B of the Act of 1913 and provides:

> "That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a *taxable person shall include,*" etc.

It follows from the decision in the First Trust & Savings Bank case, *supra*, that the above sections providing for the levy of an income tax upon the income of *individuals* and *taxable persons* has no application to income received by trustees where such income is not to be received by any individual or taxable person as set out in Sections 1 and 2 (a) of the Act of 1916-17. It follows also from the First Trust & Savings Bank case, *supra*, that when attempting to tax an income coming into the hands of a trustee where such income is not payable to any ascertained person, the trustee cannot be treated as an independent taxable person or an individual receiving an income. The government in such cases must find some special provision of the Act under which such an income received by a trustee may be taxed. In other words, in the Act of 1916-17, as in the Act of 1913, where income comes into the hands of a trustee and the government seeks to levy a tax against the trustee on account of income so received, it must rely wholly upon the language of the Act applicable to the assessment of a tax on the income received by a trustee for the benefit of another. This language in the Act of 1916-17 appears in Section 2 (b). An examination of this language entirely fails to disclose any ground for the levying of a tax on the increase in the value of capital assets in the hands of a trustee held for a life tenant and unascertained remaindermen reduced to dollars and cents, by conversion, as a single isolated transaction occurring in the course of the administration of the trusts and for the sole purpose of reinvestment for the benefit of the life tenant and remaindermen.

B.

Before scrutinizing Section 2 (b) for the purpose of construing it with reference to the problem here presented, it is not inappropriate to repeat a rule referred to by the Court of Appeals in the First Trust & Savings Bank case, *supra*. The Court there said:

> "Inasmuch as all persons and property within the jurisdiction of a sovereignty are subject to taxation, and since the property cannot speak and the persons have no direct voice in wording the tax laws, it is a fundamental duty of the lawgivers to make the scope of a tax law definite and its meaning clear; and therefore all doubts respecting scope and meaning are to be resolved in favor of the taxpayer. *Treat* v. *White*, 181 U. S. 264; *Gould* v. *Gould*, 245 U. S. 151."

It is useless to argue that "income" as used in Sec. 2 (b) by reference back to Sec. 2 (a) includes every gain to a taxable person described in Sec. 2 (a), for Sec. 2 (a) is describing the income of a "taxable person," *i. e.*, an "individual" who receives an income *for his or her own use and disposal*. But no such income is involved in the case where a trustee holds the capital of a trust fund for life tenants and remaindermen, especially where the remaindermen are not ascertained until a distant future time. In such a case when the trustee sells (as a single isolated transaction) the capital of the trust estate for the purpose of reinvestment and a gain in dollars and cents is ascertained, no one receives the gain for his or her own use and disposal. The actual gain ascertained by conversion in dollars and cents is not, as such, at the disposal of anyone and may never be, for the gain may be wiped out by losses in capital before final distribution to the remaindermen. It follows, therefore, that even if it be assumed that Sec. 2 (a) names as income the gain ascer-

tained upon the conversion of capital assets by a legal and beneficial owner as a single isolated transaction, it does not operate to name as taxable income the gain arising from the increase in the value of the capital of a trust estate held by a trustee for life tenants and remaindermen, where such gain is ascertained by conversion as a single isolated event.

The final question, then, remains: Is there anything in Sec. 2 (b) which provides with sufficient explicitness that the increase in the value of capital assets of a trust estate held for life tenants and remaindermen, ascertained upon conversion by a trustee as a single isolated event for the purpose of reinvestment, shall be income upon which a tax shall be assessed and the trustee held responsible therefor?

We submit there is nothing.

The use of the word "income," and even of the words "gains, profits and income derived from any source whatever," are insufficient under *Gray* v. *Darlington*, *supra*, and *Lynch* v. *Turrish*, *supra*, to include a gain in the value of capital assets spread over a number of years and realized by conversion as a single isolated event, and attempted to be taxed by the Government as income wholly within the year of conversion. Similar words of the statute have been held in the Towne case, *supra*, insufficient to cover so extraordinary a meaning of income as would be required to include a stock dividend. How much more, then, are such words insufficient to cover so extraordinary a meaning of income as that required where income is to include the increased value of the capital assets of a trust estate ascertained upon conversion and occurring as a single, isolated event, and in the course of the reinvestment of the capital of the trust estate in the ordi-

nary administration of trusts for the benefit of life tenants and unascertained remaindermen.

Furthermore, the entire context of Section 2 (b) is persuasive that where trustees and the trust estate are concerned, "income" was not used in any such sense as would include the increase in capital assets of the trust estate ascertained by conversion, as in the case at bar. The use of "income" in every instance is such as to imply a genuine gain "proceeding from" capital assets. Section 2 (b) refers to "income received by estates of deceased persons." This has only one meaning in common use, and that is, an income received from a definite capital investment which continues to be an invested capital even when the form is changed by conversion and reinvestment or by redemption and reinvestment. The view that an increase in the value of capital assets of a trust estate ascertained upon conversion and the proceeds actually reinvested as capital, is an income from the estate of a deceased person or a trust estate, is so entirely foreign to authoritative usage and common understanding of the word "income" in use by all who have any knowledge or contact with estates of deceased persons or trust estates during the period of settlement, that the mere use of the word "income" by Congress could not properly be construed to refer to such gains. In support of this we refer again to the cases (cited *ante, pp.* 29-38) where courts have held that the increase in capital assets of a trust estate when ascertained upon conversion, are not income as between life tenants and remaindermen.

In the next clause of Section 2 (b), Congress used the phrase "such income" and "such income accumulated." "Such income accumulated" is very significant. "Income accumulated" certainly never in any proper use of

those words referred to an increase in capital of a trust estate ascertained by conversion as in the case at bar. When, therefore, the Act referred to "such income accumulated," meaning "such income" already referred to in Section 2 (b), which may happen to be received and accumulated, it indicates that "income," as previously used in Section 2 (b), does not include the mere increase in the value of the capital assets of a trust estate ascertained upon the conversion, as in the case at bar.

Sec. 2 (b) would seem to be quite explicit that income in the ordinary sense of interest, earnings or dividends proceeding from the invested capital of a trust estate which was to be accumulated and paid or held for future distribution to persons ascertained or unascertained, is taxable. But that is the only explicit provision for the taxation of a gain not presently payable to some individual for his or her own use and disposal. An inference, therefore, arises that a mere increase in the value of capital assets of a trust estate held for life tenants and remaindermen (especially unascertained remaindermen) reduced to dollars and cents upon conversion by the trustee, as a single isolated transaction in the course of reinvestment, would not be taxable as income.

Our conclusion on this branch of the argument is as follows: The mere increase in value of the capital assets of a deceased's estate or a trust estate ascertained by conversion as in the case at bar, is not "income received by estates of deceased persons"; it is not "such income of estates or any kind of property held in trust"; it is not "such income accumulated in trust"; it is not income in any sense in which "income" is used by the Act when estates of deceased persons or trust estates are involved.

C.

It cannot be inferred from Section 2 (c) of the Act of 1916-17 that "the sale or other disposition of property" referred to therein applies to the sale of capital assets by a trustee in the course of administering the trust estate for life tenant and remaindermen and as a single isolated act of conversion and reinvestment.

Clearly this is so if, as already argued, the levying of an Income Tax against the trustee as the representative of the trust estate is determined wholly by Section 2 (b) and not at all by Section 2 (a), for Section 2 (c) obviously is supplementary to Section 2 (a) and not at all to Section 2 (b). But apart from such a contention there is a direct ground of inference that such sales by trustees are not included in or referred to in Section 2 (c). Suppose a trustee obtained by devise or settlement *inter vivos* (but not by purchase) capital assets for the trust estate subsequent to March 1st, 1913. If the capital assets increased in value and the increase were ascertained by conversion as a single isolated event, the increase is clearly not taxable as income by any provision of the Act of 1913; nor is it taxable by reason of Section 2 (c) of the Act of 1916-17, for that section only referred to sales of property acquired *prior* to March 1st, 1913. It was silent as to property acquired *afterward*. But even though we regard Section 2 (c) as providing by implication (as expressly provided in the Act of 1918, Section 202 (a) (1)) that as to property acquired after March 1st, 1913, the "cost" thereof be taken, it is apparent that property acquired by a trustee by devise or settlement has no cost so far as the trustee is concerned. Hence, Section 202 (a) (2) of the Act of 1918, which is an enlargement of Section 2 (c) of the Act of 1916-17, plainly does not refer to property acquired by a trustee subse-

quent to 1913. As already indicated, *ante*, p. 51, there can be no real gain upon which to base a tax unless there is an actual outgo, or *cost*, in the purchase of the asset which is subsequently converted. It is a fair inference, therefore, that Section 2 (c) does not refer to property acquired by a trustee as a gift and without cost, subsequent to March 1st, 1913. This also tends to show that Section 2 (a) of the Act of 1916-17 referring to "income derived from * * * sales, or dealings in property," does not have anything to do with sales or dealings in property by trustees acting pursuant to the terms of the trust in converting for reinvestment as a single isolated transaction.

D.

In determining whether the Act provides for an income tax upon an increase in the value of a trust estate held for life tenants and remaindermen, and ascertained by conversion, it is material to consider whether the statute provides for the deduction of losses in capital assets when they are similarly ascertained. Not that the government *must* allow such losses, but because a certain inference arises that if such losses are not deductible in a statute which provides for deductions for losses, the increase was not, under the statute, to be counted as income. In the case at bar nothing could be clearer than that the trustee cannot deduct losses in the value of capital assets ascertained by conversion.

The Act of 1916-17, Section 5, Subdivision "Fifth," permits a deduction for losses "in transactions entered into for profit," but the trustee never entered into the transaction in question for profit. It did not even buy the stock, but received it upon the death of the testator by will. It purchased the bonds simply for a secure and

permanent investment and the bonds were redeemed by the debtor and not sold. The trustee held the stock and bonds as a trust fund. It sold the stock for the sole purpose of making a reinvestment in more permanent securities. There was no transaction "for profit" about the acts of the trustee in question from beginning to end. Then under the Statute the losses cannot be deducted unless "actually sustained therein [*i. e.*, in the transactions entered into for profit] during the year to an amount not exceeding profits arising therefrom." This language is inept as applied to a trustee who is not engaged in "transactions entered into for profit." The trustee is not engaged in any transactions for profit. He, therefore, cannot deduct any losses. Furthermore, the loss must occur in the year in which the gain occurs, but in a trust estate the gains and losses to capital assets may occur, and usually do occur at considerable intervals and more than a year apart.

When we look at the practical difficulty in the trustee's deducting losses to capital assets, it is quite apparent that the statute never contemplated any such deduction by the trustee for the life tenant and remaindermen. Suppose a loss occurred equal to the gross income in the year, and there was no gain in the capital assets for that year, how could the loss be deducted? The trustee cannot deduct it from the income received so as to eliminate the tax because that would load the loss in capital assets upon the life tenant, and while she might pay no income tax she would also receive no income because her income would have been used to make good a loss to capital. But if the trustee does not deduct the loss from the income received and to be paid to the life tenant, the trustee has no gain from which to make any deduction and arrive at a net income to be taxed. The government would hardly tolerate a rule

which permitted the trustee to deduct the loss from the income received and then to pay over the whole income as received to the life tenant free of the tax. That would at once be branded by the government (and justly so) as the deduction of what was in reality a loss to capital from sums constituting what was in reality an income as distinguished from capital.

Conclusion.

1. If the government adheres to its position that the increase in the value of capital assets spread over a number of years is income in the year of conversion and that the whole increase is income in that single year, then it must, as we contend, upon the fair and proper analysis of *Gray* v. *Darlington* (*ante*, pp. 57-62), and *Lynch* v. *Turrish* (*ante*, pp. 63-67), insist that those cases be overruled.

2. If the government should contend that the Act of 1913 only taxed the increase occurring in the year of conversion, excluding the increase for previous years, then it must take the same view of the Act of 1916-17. The differences between the two acts are not such as to warrant a difference in result in this respect. The words "received," and "arising or accruing," are interchangeable. (*Ante*, pp. 81-86.) Gain "received" in the preceding calendar year may just as well refer to the gain of the year of conversion as when the act reads, net income "arising or accruing" in the preceding calendar year. It would follow that in the case at bar, under the Act of 1916-17, the only tax that could be levied would be on the income which occurred in the year of conversion. This would result in a tax of less than $2,000.

3. If the government concedes that under the Act of 1913 no tax could be levied upon an increase in the value of capital assets until conversion, but contends that since it is in reality the gain which is taxed and not the proceeds of the gain on conversion, it is the gain in each year which is taxed and the gain in each year, therefore, must be taxed, if at all, under the act in force in that year, then the same view of the Act of 1916-17 must be adopted. Again, there are no such differences in the statutes as require a different result in this respect. It is just as proper to give such an interpretation to an act which taxes net income "received" in the preceding calendar year as to one which taxes net income "arising or accruing" in the preceding calendar year. The words "received" and "arising or accruing" are, as used in the two acts, interchangeable. (*Ante*, pp. 81-86.) It is as proper to construe the Act of 1916-17 as taxing a gain "received" for the preceding calendar year (as distinguished from "the proceeds of the gain received in the preceding calendar year") as it is to construe the Act of 1913 as taxing a gain "arising or accruing" in the preceding calendar year (as distinguished from "the proceeds on conversion of the gain arising or accruing in the preceding calendar year").

The Act of 1916 would, under this view, be effective to tax the gain in the value of the stock in question which occurred in 1916, and the Act of 1917 would be effective to tax the increase in the value of the stock in question in that year. Such a view would also greatly reduce the amount of the tax which the government could rightfully claim and the plaintiff in error would be entitled to a reversal of the judgment.

4. The government has never taken any such views of the Act of 1913 or of the Act of 1916-17. Under the

claim which it now asserts under the Constitutional Amendment and the Acts of 1913 and 1916-17 the government insists it is permitted to treat as income in the year of conversion the entire increase in the value of capital assets which may have occurred over a series of years. To maintain such a position it is now driven to ask this court to overrule *Gray* v. *Darlington* and *Lynch* v. *Turrish*, not only in so far as they settle the meaning of the Sixteenth Amendment, but also in so far as they settle the meaning of the Act of 1913 and, by legitimate inference, the meaning of the Act of 1916-17.

Respectfully submitted,

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